TC01603

Income tax and National Insurance Contributions - IR35 case involving a company indirectly contracting to provide the services of an IT specialist to Allianz - change in the relationship after a period - Appeal allowed in part

FIRST-TIER TRIBUNAL **Reference no: TC/2009/15078**

TAX

JLJ SERVICES LIMITED

Appellant

-and-

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS

Respondents

Tribunal: HOWARD M. NOWLAN (Tribunal Judge)
ANDREW PERRIN F.C.A.

Sitting in public at Vintry House in Bristol on 24 and 25 October 2011

Neil Awbery of Clearsky Accounting on behalf of the Appellant
David Lewis, Higher Officer of HMRC, on behalf of the Respondents

DECISION

Introduction

1. This was a case of the type, usually referred to as an IR35 case, where the issue before us was whether Mr. John Spencer ("Mr. Spencer"), an IT specialist, would have been regarded as an employee of Allianz Cornhill Management Services Ltd ("Allianz"), had he rendered services to that company under a direct contract between himself and Allianz. As it was, he was employed by the Appellant, his own company, albeit that there was no written employment contract between himself and the Appellant; the Appellant then contracted to provide his services to Highams Recruitment Limited ("Highams"), Highams essentially being his and the Appellant's agent; whereupon finally Highams contracted to provide Mr. Spencer's services to the ultimate client, namely Allianz.

2. The tax and duty in dispute were PAYE income tax and National Insurance Contributions, both employer and employee Case I contributions. The dispute spanned from the tax year 2000/2001 to 2007/2008, and the total claimed amounts were £91,443.48 in tax, £61,268.35 in NIC, and interest of £48,048.46. It was accepted by HMRC that if the appeal was dismissed, such that the analysis was that Mr. Spencer should be regarded as always having been an employee, then tax already paid by the Appellant in Corporation Tax would be refundable, provided at least that earlier periods were still open for adjustment. Insofar as Mr. Spencer had received some salary and dividends from the Appellant, then tax already paid in respect of salary and dividends would also be deducted against the gross figures just mentioned. We were not concerned with the detailed figures, though it appeared that the net liability, for which the Appellant alone would have been directly liable was roughly £141,000. Whilst there is no direct relevance to this fact so far as this appeal and our decision are concerned, we were also told that by the time the Appellant had paid for the costs of the appeal, its retained funds would be only about £2000.

3. Our decision is that it is realistic to conclude that Mr. Spencer's notional status, either as an independent contractor or an employee of Allianz, actually changed during the period. The precise point at which the change occurred is not easy to define, but at the end of December 2003 there were various indications that the relationship did then change. Our decision is accordingly that in the early period, prior to the end of 2003, Mr. Spencer would not have been regarded as an employee, but that from the start of 2004 onwards, he would have been regarded as an employee. We will of course explain the reasoning for our conclusions for the periods on each side of that dividing line.

The evidence

4. Evidence was given before us by Mr. Spencer, and by two employees of Allianz, namely Karen Ballard and Mick Devereux, who gave evidence on behalf of the Respondents. There was no material dispute in relation to the evidence, and we will summarise the evidence in recording the facts below. We will also mention minor differences of emphasis, but nothing derogates from the fact that we were entirely satisfied that all three witnesses were describing aspects of the relationship in a broadly similar manner and all were entirely honest and trustworthy.

The law

5. The terms of the relevant legislation for income tax and NIC purposes is broadly the same. The current income tax wording, found in section 49 of the Income Tax (Earnings and Pensions) Act 2003 provides that:

> *"49(1). This Chapter applies* (i.e. meaning, in the circumstances of this case, that the Appellant would be treated as having paid employment income of a calculated amount to Mr. Spencer) *where:-*
>
> *(a) an individual ("the worker") personally performs, or is under an obligation personally to perform, services [for another person] ("the client"),*
> *(b) the services are provided not under a contract directly between the client and the worker but under arrangements involving a third party ("the intermediary"), and*
> *(c) the circumstances are such that, if the services were provided under a contract directly between the client and the worker, the worker would be regarded for income tax purposes as an employee of the client.*
>
> ……
>
> *(4) The circumstances referred to in subsection (1)(c) include the terms on which the services are provided, having regard to the terms of the contracts forming part of the arrangements under which the services are provided."*

6. We consider it unnecessary to quote the broadly similar NIC wording. The most material minor difference is that for NIC purposes there is not the same direction to consider the "circumstances" relevant to the notional direct relationship by *"including the terms on which the services are* [actually provided under the actual contracts]", in the manner referred to for income tax purposes by section 49(4), just quoted. Since however, neither party advanced any point in relation to any perceived difference in the wording for the different tax and duties, and since indeed section 49(4) only tells one to include the terms of the actual contracts amongst the circumstances to be taken into account in applying section 49(1)(c), and we conclude in this case that other general factors are of far more significance than the formal terms of the existing contracts, we will ignore any difference between the two forms of wording.

7. The sole question of principle for us, therefore, is whether, had Mr. Spencer performed his services for Allianz under a direct contract between himself and Allianz, he would have been treated as an employee or as an independent contractor.

The background

8. At the date of the hearing, Mr. Spencer, now 66 years of age, had been retired since 2007. He had clearly had a very long career in Information Technology ("IT"), and must have been one of the early computer specialists. We were told that from 1963 to 1991 (27 years) he had worked for STC, being made redundant in 1991. There is then some significance to the fact that he was unemployed for a 2-year period, trying but failing to gain replacement employment. In order to secure work he signed up with a firm specialising in finding placements for IT specialists, namely Highams. We understand that in 1993 and 1994, he was contracted to supply services to Highams, who made his services available first to Texas Instruments in Bedford for 14 months, and then to BAE systems for 2 months.

9. In 1994, there was again a period (of 4 months) when Mr. Spencer was out of work. It was also at this time that he formed his company, the present Appellant, with a view to the company providing his services to Highams, and Highams then on-providing the services to ultimate clients. We did not ascertain precisely why the Appellant was formed, and it may have in part been formed because Mr. Spencer might have gathered, or Highams might have suggested to him, that there would be some tax savings, and in particular NIC savings if the Appellant only paid on a modest proportion of its service fee income as salary to Mr. Spencer, paying Corporation Tax at the small companies' rate on the balance and paying out the after-tax income as dividends to Mr. Spencer. It seems, however, equally or more likely that the driver for the formation of the Appellant was an insistence by Highams that he form a company and provide his services through the company. The explanation for this suggestion is that, prior to the introduction of the IR 35 legislation, Highams would very likely have had a concern that if it continued with a direct contract with Mr. Spencer, and HMRC contended that Highams was then Mr. Spencer's employer, Highams itself would be exposed to the risk of PAYE and NIC liabilities by continuing with a direct contract with Mr. Spencer, and contending that that relationship was not one of employment. The interposition of the Appellant would insulate Highams from this risk. There was no specific evidence that this was the explanation for the formation of the Appellant, but we were certainly told that all similar work procurement agencies like Highams all insisted that their "casual" workers form a company, and that it was thus that company and not the underlying individual that contracted to supply services to the "work-placement" company. It very much sounded as if Mr. Spencer had found that he was unable to obtain full-time employment, similar to his original STC work, and unable to obtain work through agencies unless he formed the company that he did form.

10. From 1994 to 2000, Highams found work for the Appellant and Mr. Spencer with six different ultimate clients, the two shortest engagements being for 3 months, and the two longest for 18 months. There were 3-month gaps, with no available work, between the last three of those engagements.

The work for Allianz

11. After a 3-month gap without work, Highams obtained a 6-month engagement for the Appellant and Mr. Spencer with Allianz, the German insurer that had taken over Cornhill, at their Guildford offices. This engagement commenced in May

2000. Allianz were particularly keen to engage someone very quickly to undertake a project geared to installing and writing programmes for systems referred to as Unix systems. The reason for needing to engage someone quickly was because the person who had previously been doing the work was leaving, and Allianz particularly wanted the replacement to be able to attend handover sessions with the predecessor. Accordingly the Appellant and Mr. Spencer were essentially given the engagement following a telephone interview. Mr. Spencer was at the time living in Harlow, a journey round the M25 from Guildford, which was why, once he had convinced the relevant people at Allianz that his speciality was indeed everything to do with Unix systems, he was engaged without a face-to-face interview and with a view to starting the project immediately. We were certainly convinced that Mr. Spencer seemed to be a very knowledgeable expert in relation to his particular field of installing and writing programmes for Unix systems, and can well believe that he would have immediately struck those at Allianz as well able to deal with their requirements.

12. Although we were shown written contracts between the Appellant and Highams and Highams and Allianz, those contracts all commenced at a slightly later date, and nobody now had copies of the contracts that operated for the initial engagement. We were told, however, that the initial contracts were very similar to the later contracts that we were shown.

13. In relation to contractual arrangements, we should mention the following points. Firstly, Allianz entrusted all its requirements for procuring computer specialists to a firm called Omni Recruitment ("Omni"). Omni dealt with securing both employees for Allianz, and, where appropriate, contract workers as well. We were told that it was not clear whether Mr. Spencer's services were provided via a chain of contracts, namely the unwritten employment contract between Mr. Spencer and the Appellant, the contract between the Appellant and Highams, an unseen contract between Highams and Omni, and then finally one between Omni and Allianz. That actually seems wrong to us since we were shown an actual written contract between Highams and Allianz, with no reference to any interposition of Omni. We assume therefore that Omni was simply acting as Allianz' agent.

14. The wording of the two written contracts that we were shown, namely the ones between the Appellant and Highams, and between Highams and Allianz were virtually identical, and were in particular identical in relation to various of the terms that were drawn to our attention. We will deal with them below but in summary those terms were the terms relating to the Appellant having a qualified right to provide a substitute worker for Mr. Spencer, the terms in relation to "control", and the terms in relation to hours of work and termination. At present we will simply record that there seemed to be every indication that the Allianz/Highams contract was the one that initially governed the terms; it seemed that the Highams/Appellant contract had then been drafted to match and mirror the terms of the Allianz contract; and it also seemed virtually certain that the initial Allianz/Highams contract would have been a general one in use for any contract workers working through "their companies", that might be engaged by Allianz, though Omni.

15. We have already mentioned that the first engagement was for a 6-month period, and in a schedule given to us of the dates for the various contract extensions and projects within each extension period, the project required to be done in that first

period was referred to as "Upgrade systems". In the period between commencement in May 2000 and 31 December 2003, the pattern of engagements and agreed extensions was fairly similar. With the sole exception of one 10-month extension, all of the later extensions were for short periods, one for 1month, two for 2 months, three for 3 months and two for 4 months. Most but not all of those contract extensions gave an indication of the particular project to be undertaken, and the name of the manager within Allianz for whom the project was essentially being done.

16. By contrast to the position prior to the end of December 2003, the position thereafter (until the last few months before the very end of the overall engagement in 2007), was that the contract extensions were for 12-month periods, and no project descriptions were given thereafter. We were also told that at the end of December 2003, Allianz sought to engage Mr. Spencer on an indefinite basis. There was slight confusion as to whether he was actually offered employee status, and if he was he definitely said that he declined that. He was certainly offered an indefinite appointment, and whether he actually declined that or not, as we have just indicated the contract extensions were for the entire years of 2004, 2005 and 2006, and there was no mention of identified projects against those extensions.

The particular terms of the contracts, and surrounding evidence in relation to each particular term

17. We will now summarise the terms of the two contracts in relation to the points material to the dispute, and then add the evidence of the parties in relation to each.

Substitution

18. The Appellant's representative placed considerable reliance on the clauses of each contract that sought to entitle the supplier to send a substitute worker, in place of Mr. Spencer. The relevant wording of the contract between the Appellant and Highams was that:

> *"3.1.5. The services shall be performed by the Contractor. However, the Company may send a substitute of equal experience and ability to perform the Services as set out in the Schedule. In the event of a change, the Company and/or the Contractor shall submit to Highams the names of suitably qualified substitutes and shall permit the Client an opportunity to interview such proposed substitutes."*

Whilst we are not at this point giving our own view on the proper interpretation and the relevance of this clause, we should just refer to two obvious ambiguities. Firstly, it was not clear what would happen if the Appellant proposed a substitute with the requisite "experience and ability", but Highams, and indirectly under the other contract Allianz, did not approve of the offered substitute at the interview. Could Allianz reject such a substitute? Secondly the defined term "Contractor" was also somewhat curious. We accept that where we were shown letter agreements extending or rolling over one contract to the next period, Mr. Spencer was generally identified as "the Contractor". However the contract itself defined the "Contractor" as "the individual undertaking the specified services on behalf of the Company". On one interpretation, that indicated that even Mr. Spencer was not identified as the

relevant supplier. We accept that this was never even advanced in argument, and as we have said, the renewal schedules did generally identify the ultimate supplier as Mr. Spencer.

19. Mr. Spencer's evidence was that he attached some importance to this clause, in that if he was ill or unable for some period to do the work, were he able to offer a substitute, this would protect his company's continuing ability to retain its contract, and the connection to Allianz, and thus give him a better chance of resuming work.

20. Mr. Spencer admitted that the Appellant had no other employees, and certainly none that could meet the requirements for acting as a substitute. He did, however, say that during his career he had made many contacts, and that he knew of two people who did have the requisite experience to fulfil the substitute role.

21. The Respondents' witnesses did not dispute that if Mr. Spencer was unable, through illness or some other reason, to do the work, and the Appellant offered a substitute of whom they approved during interview, they would accept that substitute. They certainly indicated however that they would have a discretion in the interview process as to whether to accept the substitute. They also said that they would equally look to their normal supplier, Omni, to provide a replacement worker, and that it would take any substitute three weeks to be of any use, since the substitute would have to learn much about Allianz's existing procedures and systems. Mr. Devereux also said in evidence that he was unaware of the existence of the substitution clause. It was then pointed out to him that, in earlier interviews with HMRC, he had revealed that he had been aware of it, and had expressed some view in relation to it. We did not treat Mr. Devereux's statement in evidence that he was unaware of the clause as indicating that he was giving dishonest evidence. We rather took it to exhibit a realistic businessman's contempt for a clause that he probably found irrelevant, a view somewhat in line with the one that we will reach in explaining our decision below.

Control

22. Two clauses of the Appellant's contract with Highams related to "rights of control", though their emphasis was principally on regulations and health and safety matters. They read as follows:

> *"3.1.6. while on the Client site, to comply with all lawful and reasonable directions of the Client with regard to health and safety issues and rules pertaining to the management of the building and will conform to the Client's normal codes of staff and security practice;*
>
> *3,1,7. the Services shall be performed in compliance with all applicable laws, enactments, orders, regulations and other similar instruments (including but not limited to applicable health and safety legislation);"*

23. The general evidence in relation to Allianz's right of control over Mr. Spencer was very much as one would obviously expect in the relevant circumstances. In other words, Allianz would decide on the next project to which Mr. Spencer would be assigned, and there would then be discussion as to how long that project would be

likely to take, and what further support from Allianz's employees Mr. Spencer would need in order to complete the project. Since it was manifest that Mr. Spencer was an expert in his field, and Allianz conceded that there was nobody in their own organisation who would know in detail how Mr. Spencer was then approaching his task, and whether he was pursuing it in the best manner, there would be little intervention with the day-to-day work that Mr. Spencer would then be doing. Obviously Allianz would enquire about progress, particularly if a project was over-running the expected period assigned for completion of the project. Furthermore, Allianz also said that it had the right, if some emergency arose, to require Mr. Spencer to pause in work on a particular project if some other matter needed to be attended to first. The example given was that, since Allianz was quoted on the New York Stock Exchange, there could be occasions when US filings had to be made within some deadline and this might require Mr. Spencer to give his attention to ensuring that the programmes enabled people to marshal the required information for the US filings, only then resuming the earlier project when this urgency had been attended to.

24. There was a slight, and understandable, difference in the evidence as to whether Mr. Spencer's performance was assessed, and whether in other words he was subjected to "quality control". Mr. Spencer indicated that there was no quality control at Allianz, at least of the type that he had been used to at STC. In contrast the Allianz witnesses said that there was some quality control. A relevant overall summary seems to us to be that it is not surprising that when Mr. Spencer had worked for a major computer company such as STC, a one-time affiliate of the US's ITT, the entire business would have been filled with computer experts and there would have been extensive quality control. By contrast at Allianz there would have been sufficient quality control for the management to derive confidence that Mr. Spencer was well able to accomplish the projects assigned to him, but nobody in the company would have had the detailed knowledge of Mr. Spencer's field of expertise to judge whether in every respect he was tackling his projects in the best way.

Working hours, lack of employee benefits and termination terms

25. The contracts themselves were strangely silent about working hours, though the renewal schedules generally indicated the hours to be worked by Mr. Spencer. When he was working five days a week, that is in the period up to his home move from Harlow to Somerset in mid-2004, the renewal letters generally indicated that he was to work for 37 ½ hours a week. After the move, he worked a three-day week from Tuesday to Thursday, and was generally expected to work for 22 ½ hours a week.

26. In reality the position was reasonably flexible. The Appellant billed Highams, and Highams billed Allianz for hours actually worked. If Mr. Spencer worked slightly more hours or fewer hours than the target 37 ½ and 22 ½ he simply billed for the hours worked. Alternatively, and if more sensible, if he worked a few hours short in one week, he might make them up in the following week or following weeks. Mr. Spencer could not simply increase his earnings by working significantly longer hours, and billing for them, without discussing matters with the relevant managers. During the total period when Mr. Spencer was working for Allianz, Allianz introduced a time sheet system under which its own employees were required to fill in time sheets, and allocate their time to particular matters and projects for cost-control

purposes. Mr. Spencer was required to participate in this system, along with the company's general employees, but the remuneration due to the Appellant was still entirely governed by the invoices submitted by the Appellant to Highams.

27. Mr. Spencer was not required to "clock-in" as employees were required to do though he generally worked for normal working hours. On occasions, when a project required that he work when the computers were not being used by the normal staff, he would then work out of normal hours. In a practical common sense manner, such matters would simply be discussed and agreed with the relevant managers in the business.

28. Mr. Spencer almost always worked at the Guildford offices of Allianz. He occasionally worked at a disaster recovery site that the company had near Heathrow, and once attended meetings in Bristol. He always worked on the company's computers, for computer security reasons, and could not attach his own laptop computer to the company's systems. He did virtually no work at home, though occasionally took telephone calls, and might download information at home on his laptop that he might find of use in performing his services.

29. Since the Appellant billed Highams, and indirectly Allianz, simply for hours worked, there was the familiar position for contract workers that Mr. Spencer was not given paid holidays or payment when off work through illness. He also enjoyed no pension rights, and was not given any of the fringe benefits given to normal staff. He paid for meals even, we were told, the Christmas lunch, when other staff enjoyed certain benefits in this regard. He did not have a company car, and although he occasionally travelled as a passenger in a company pool car, he never drove one. It was even the case that if Mr. Spencer used his own car on Allianz business, he was not reimbursed for any costs. Needless to say, the Appellant's hourly charging rate was higher than the rate that Mr. Spencer might have commanded had he been an ordinary employee, and had he enjoyed the ordinary employee benefits of paid holidays, paid sick-leave etc.

30. There were no written terms that governed when Mr. Spencer might actually take holidays. As a courtesy he always agreed absences for holidays in advance, and generally at times when work projects made absence less disruptive.

31. Either party could terminate the contract with four week's notice. Obviously the contract could also be terminated immediately for gross misconduct etc., and somewhat oddly, although the contracts at both levels could not be terminated in the event of short illness, they could be terminated for any illness for a period of more than two weeks. In the seven years during which Mr. Spencer worked with Allianz, he was in fact never ill.

The parties' intentions

32. Both contracts contained an identical clause, indicating that "any Contractor supplied by [the Appellant] shall not be deemed to be an employee, agent or partner of Highams or the Client."

Other relevant evidence

33. We will now summarise a few more matters revealed in evidence that were not directly related to any terms of the contracts.

The German parent company's requirements in relation to employee numbers

34. We were told that Allianz itself had an extraneous reason for preferring to engage Mr. Spencer as a contract worker, rather than as an employee, certainly in the period after 2003, when Mr. Spencer dropped down to working on a part-time basis. This was because Allianz's German parent company laid down internal rules for the numbers of strict staff members who could be engaged in particular areas of the business, and when 1 ½ staff members were designated as permitted for a particular area in which Mr. Spencer was working, it was highly convenient that, as a contract worker, he could be excluded from the headcount.

Other contract workers

35. We were told that, during the period when Mr. Spencer worked for Allianz, he was certainly not the only worker engaged on a contract basis. No evidence was given in relation to the other such workers, but we were certainly told that even today, at the date of the hearing, Allianz had a number of contract workers working for it, generally on a very short-term basis, and that so far as Allianz was concerned, it had not heard that any were being challenged under the IR 35 legislation. We repeat that no evidence was actually given about this, but the expectation that short-term workers of a particular category would not be challenged under the IR 35 legislation does seem realistic to us, and it forms part of the decision that we have reached.

The "own business" test, financial risk and the provision of tools

36. In view of the fact that one of the pointers in favour of saying that a worker is a contract worker rather than an employee is the feature of the worker having his own business, and financial risk, we should record the following evidence. It was accepted that Mr. Spencer worked almost entirely with "tools" provided by Allianz. The only business or financial risk referred to was the risk that even if Allianz paid Highams, Highams might become insolvent, such that the Appellant would not be paid for hours worked by Mr. Spencer.

The contentions of the parties

37. Cases of this nature are very familiar, and it is unnecessary to record the contentions of the respective parties in detail. The pointers towards employment and against employment are all well known. We simply add that both parties treated as their starting point the three tests laid down by MacKenna J in the case of *Ready Mixed Concrete (South-East) Ltd v. Minister of Pensions and National Insurance* [1968] 2 QB 497. Those three tests are the provision of work on a personal basis, the "engager" having sufficient rights of control to make the engager "master", and the other provisions of the contract being consistent with the contract being one of service. The Appellant's representative placed particular emphasis on the feature that the substitution clause indicated that the contract was not one for the

provision of personal service, but one where the Appellant could provide an alternate to render the services.

Our decision

38. The case law authorities in relation to this subject have placed emphasis on a number of tests, and we will start by commenting on each test, and the relevance that it has in relation to this case. Those tests are:

- the feature of personal service;
- the degree of control;
- the consistency of other terms;
- the issue of whether the provider of services has his own business, and
- the slightly nebulous issue of "mutuality of undertakings".

The issue of personal service and the significance of the substitution clause

39. We stop short of saying that the substitution clause in this case was a complete "sham". We accept that if the Appellant had notified Highams, and indirectly Allianz, that Mr. Spencer was going to be unwell, or absent, for a long period for some reason, but that the Appellant had managed to engage a suitable substitute, and that substitute passed Allianz's interview test with flying colours, then it is indeed possible that the Appellant could have continued to bill for the services of the replacement.

40. That, however, is the extent of the reality of the substitution clause. It is perfectly obvious that, as with all similar contracts drafted to seek to sustain non-employee status, the clause was inserted to achieve the desired tax purpose, and it has virtually no bearing on our approach to the decision in this case. The reasons why we consider it to be irrelevant are as follows:

- Although the clause that we have quoted was ambiguous, in that it did not make it clear whether Allianz could reject an offered substitute, said to be experienced etc, if that substitute failed the interview test, it was pointless to provide for an interview if Allianz could not reject an offered substitute. We accordingly conclude that the substitution right was certainly not an unfettered right. The authorities make it clear that such a fettered right is of only modest significance.
- Substitution should be considered in at least two contexts. In a case where substitution is a reality, it is perfectly possible that a substitute might be offered just on an isolated day. Take the case of a company offering a driver to drive a firm's office cars, with the clause that Mr. X would generally be provided, but that in his absence another of the firm's available drivers would be provided, it would then be clear that this contract was not a contract for the personal service of Mr. X. In the present case, it is inconceivable that the Appellant could have sent a substitute on this basis, when Allianz has indicated that it would take a replacement three weeks to be of any use. This means that the only context in which substitution could be a conceivable reality is where Mr. Spencer was going to be absent for a long period.

- There seems, however, little reality to the proposition that the Appellant might have even been able to offer a replacement where Mr. Spencer would be unavailable for a long period. It had no other employees. Even if Mr. Spencer knew of two people who might be suitable, there could be no knowing whether either might be available. In all probability they would have existing engagements, or be working or living miles away. In the improbable scenario that one might have been available, it is far from clear that such a person could have, or would have wished to provide services indirectly by entering into some contract with the Appellant.
- In seven years, no substitute was ever offered, because it was never relevant, and it was perfectly clear that Allianz was interested in the qualifications and the individual suitability of Mr. Spencer, and would have been equally interested in the personal suitability of any replacement.

41. It seems to us that the substitution clause was one of the type always inserted in cases of this nature, having very little reality and that it should play virtually no part in influencing our decision.

The degree of "control"

42. When a worker is engaged on a part-time basis, engaged to undertake a particular project, the project is unique and not one that the engager would need undertaken repeatedly, and is one where the person engaged alone has the expertise to implement the task, we consider that the degree of control to be exercised is very modest. We accept here that in the early period when Mr. Spencer was engaged for his first single project, and even when he was re-engaged for defined projects, it is realistic to say that the control over his work was limited. Of course Allianz could say what it wanted done, and what the project was. Of course Alliance could divert Mr. Spencer to something that was suddenly urgent if some US filing requirement required urgent attention for a short period on some different work. But whilst Mr. Spencer was undertaking the project for which he was specifically engaged, we consider that he was using his expertise in a manner that could not be controlled in the sense of "how" he did his work. The control was therefore limited.

43. At the end of 2003, if not before, it became clear that Allianz wanted Mr. Spencer's services permanently. It no longer engaged him for projects. It either offered him employment, or permanent engagement, and even if he rejected that, he was thereafter engaged on an annual basis. In other words he became one of Allianz's key computer experts, available for work that was likely to be available indefinitely. He certainly ceased to be engaged just for identified projects. By breaking the link with projects, and indicating that Mr. Spencer would work generally within the organization, we consider that from 2004 onwards, there was more reality to control.

The supplier's own business

44. There are three features that we should consider in relation to the issue of whether Mr. Spencer would have been considered to be undertaking "his own business" on the notional direct contract with Allianz that we are required to assume.

In our view he fails on the first two, but there is something to be said in relation to the third.

45. The first respect in which Mr. Spencer would fail the "own business" test is that when engaged, he had no opportunity to make more or less profit according to how efficiently he worked, how he managed to minimise and control costs, and manage the cost of tools, assistants etc that would be involved if he was conducting a business in the ordinary sense. Mr. Spencer was simply paid for hours worked.

46. It was suggested that since he might suffer financial loss if Highams went bankrupt, this was a financial loss that supported the "own business" case. We do not agree. The sort of financial risk that sustains the business case is the loss, or the diminished profit that results from costs not being controlled, or a project being undertaken on an inefficient basis when a price has been quoted for a project, rather than the supplier being paid on an hourly basis.

47. We do consider, however, that in one respect there was some reality to the contention that Mr. Spencer should be considered to have been conducting his own business. This was not raised in argument, but it still appears to us to have some degree of reality.

48. When Mr. Spencer was made redundant by STC, he sought replacement employment and for two years he was unemployed. He then concluded that he was only likely to obtain work through agencies, and the work that he did obtain was all short-term project work. It very much seems to us that he had a particular skill to exploit and market (that of setting up Unix systems and writing programs for them), but that that was not a service for which companies engaging him expected to need his services on an indefinite basis. They had short-term projects. They wanted Mr. Spencer for the project, but then foresaw no continuing role for him. Therefore he was exploiting a specific skill that he had, for which different clients had short-term demands, and he did indeed take the risk that there would be very significant periods during which he would have no work. Totalling up the periods during which Mr. Spencer did not work, following his redundancy at STC, there were periods of 24, 4, and three periods of 3 months without work (namely 40 months).

49. We consider that there is a distinction to be made between someone in the situation Mr. Spencer was in, in the period from 1993 to 2003, and the situation of many other part-time employees. If a seaside hotel engages someone to be a waiter in the summer season, that person works in exactly the same way as all other waiters, entirely under the control of the management, and it would be quite unrealistic to say that the waiter was exercising a special skill, rendered to different clients, in some continuing business of being a waiter. Mr. Spencer did appear, however, to have a somewhat "niche" specialty skill that he could only exploit on a part-time basis that clients would only want for the duration of the projects, and in a very modest respect we consider that would have given some modest support to his "own business" case, had he been engaged directly by Allianz, at the time when he was engaged for specific projects.

The "mutuality of undertakings" test

50. There is considerable case law in relation to this test, progressively indicating that the test is of diminished importance, or that it is indeed nearly meaningless. Some case law relates to the situation of "umbrella contracts" between separate periods of admitted employment, and it is far from clear to us that the "mutuality of undertaking" test is of much assistance to us in this case.

51. There is a feature in this case where the phrase "mutuality of undertakings" has some resonance. A touchstone of being an employee is the hope and expectation that there will be some relationship of faithfulness between employer and employee. In other words, the employer will generally endeavour to keep staff employed even when work is short. Contract workers will be dispensed with first. Employees will commonly have several "employee benefits", and in particular pension rights. With short term engagements, none of this will be relevant with contract workers. Particularly in the early period, with the first and few following projects, we accept that Mr. Spencer never knew whether the various contracts would be renewed. He had been used to short-term engagements with worrying gaps between most of them, and would certainly not have felt confident that he had been taken on, with some hope or prospect of being engaged, and looked after, as a valued employee of Allianz.

The German motivation to engage contract workers rather than employees

52. We referred, in paragraph 34 above, to the rather curious way in which Allianz had some motive for engaging people as contract workers, to circumvent the limitation on employees for particular projects laid down by its German parent company. No evidence was given to the effect that this practice was deliberately undertaken in wholly unrealistic circumstances, but we nevertheless record the obvious point. This fact tends to indicate that, for irrelevant reasons, Allianz might have had a temptation to regard people as not being employees, when in reality they had all the hallmarks of being employees. Thus, to some degree, this factor tends to undermine the feature that Allianz allegedly regarded it as realistic to engage, or rather to continue to engage, Mr. Spencer indirectly for a very long period, purely as a contract worker.

The parties' intentions

53. We attach very little or no importance to the protestation by the parties to the contracts that they regarded Mr. Spencer as not being an employee. Quite apart from the fact that we must address a notional contractual situation that was not the one that the actual parties were in fact considering, their opinion on what is a matter of realistic construction of the overall facts is of very minor significance.

The distinction that we draw in this case

54. Our decision is that in testing whether Mr. Spencer would or would not have ranked as an employee at the point in mid-2000 when we must first address the key question, posed by the notion that he had a direct contract with Allianz, the answer is that he would have been a contract worker, and not an employee.

55. The type of situation, where we consider the contract worker analysis to be realistic is the one where:

- an individual has a particular area of expertise;
- that area of expertise is one that he has found has not enabled him to gain full time employment;
- the explanation for not gaining full-time employment is that the area of expertise is likely to be one that various companies might need, but not on an indefinite basis, but rather simply to complete a particular project;
- the type of work for which the worker is engaged is likely to be work outside the core work of the business.
- the individual has only been able to gain work through rendering his specialist expertise available through placement agents;
- the past pattern of work has confirmed all the above points of short engagements with different companies, and many unwanted gaps between engagements;
- the area of expertise is likely to be one where the client would indicate the project to be done, and the hoped-for time frame for completion of the project, but would not expect to be able to supervise or "control" the worker in any way, simply because the expert would be engaged to do something outside the expertise or competence of the company; and
- the company engaging the individual, engaging him for a project, would consider it quite inappropriate to provide holiday pay, pension benefit, and the other normal incidents of employment because they would all be inappropriate for such contract workers.

56. When the Appellant first indirectly entered into contracts with Allianz, we consider not only that all the above criteria were satisfied, but we take note of the fact that the fact pattern from the recent past would have rendered it very unrealistic (had the IR 35 rules then been in force) for HMRC to have contended that Mr. Spencer would have been an employee of VAI, the company for which he worked for 3 months (with a 3-month gap both before that engagement, and also after it and before the Allianz engagement). The past pattern seems to us to have been entirely consistent with the factors that we have just indicated seem to us to make "contract" status realistic.

57. We also note that shortly after the contracts were entered into in mid-2000, and indeed even at the time of the hearing, Allianz confirmed that it had engaged, and was now engaging, some workers on a contract basis, without regarding them as employees. Obviously we were given no evidence in relation to these cases, albeit that we were told that there had been no indication of any challenge by HMRC other than in the case of Mr. Spencer. Where, however, the criteria that we have summarised at paragraph 55 were satisfied, then it seems to us that non-employee status would have been perfectly realistic.

58. The situation altogether changes, however, certainly by the point in late 2003, when Allianz offered Mr. Spencer either employment, or indefinite engagement, and when in any event the parties moved to a pattern of annual renewals on a non-project basis. It seems perfectly evident to us that from that date onwards, Allianz regarded Mr. Spencer as someone who they wished to engage and retain indefinitely, and when

Mr. Spencer continued to work for Allianz, and accepted yearly contract extensions, it seems realistic to say that his status must have changed. He would by then plainly not satisfy many of the tests included in the bullet points in paragraph 55 above. He was engaged on an entirely personal basis. The substitution argument was basically irrelevant "window-dressing". If he was to be engaged indefinitely on a non-project basis, it seems likely that he was proving useful in numerous respects in relation to computers and IT, and no longer just undertaking his defined projects. So the "control" argument becomes stronger. And fundamentally Allianz wants to engage him as a permanent member of the team.

59. Our decision is accordingly that initially it would not have been appropriate to classify the notional relationship as one of employment. Certainly from January 2004, it would have been appropriate to regard the notional relationship as one of employment. We put the dividing line at 31 December 2003 because it was at that time that he was offered indefinite work, and it was from that date that renewals were agreed on an annual basis, and from which no further reference was made to particular projects.

60. We consider that it is possible that we have put the dividing-line in the wrong place, and that if we have done, the change-over to notional employee status would in fact have taken place well before 31 December 2003. We still consider, however, that the reason underlying the point in the last sentence of paragraph 59 is cogent, and we confirm that as the date when the status changed.

61. This Appeal is accordingly allowed in part.

Right of Appeal

62. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal)(Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

HOWARD M. NOWLAN (Tribunal Judge)

Released: **28 November 2011**