

## **THE CASE LAW AND HOW IT RELATES TO YOUR CONTRACT**

There is no statutory definition of employment or self-employment so we have to look to the courts and the decisions that have been made over the years where the employment status of a person has been decided. These decisions relate to tax, NIC and also employment law rights including unfair dismissal cases and holiday and sick pay cases etc. Consequently there is a large body of case law to consider.

IR35 is concerned with showing that you are not a “disguised employee” of your client and it is necessary to look at all the factors in the relationship. This includes all the terms and conditions set out in any written contract as well as what actually happens in reality. It is then necessary to apply up to date case law precedent to the findings.

This is a short guide to the principles established by the courts and how they relate to the specific clauses in your contract. You should remember that IR35 is new legislation and although it relies upon the old status tests from cases that have gone before the courts in the past each case has to be decided on its own merits. The emphasis the courts have given to particular factors has changed over the years, as has the Revenue's interpretation of the courts findings.

### **SUBSTITUTION**

We are looking to see in your contract a not unreasonably fettered right to send a substitute. The clause must be a genuine right. Clauses, which merely allow the personal service business to “offer” a substitute, are not reliable, as the client could simply say no. The same can be said of the need for the client's permission or approval before a substitute is sent. This effectively negates the right and would be viewed by the Revenue as an unreasonable right to veto.

“Freedom to do a job by one's own hands or another's is inconsistent with a Contract of Service.” This is a quote from McKenna J in the 1968 Ready Mixed Concrete case. It is recognised that this case set out the need for personal service as a necessary requirement in a relationship of direct employment. The right of substitution is a fundamental status test and if it is genuinely possible to send a substitute there can be no employment.

It should be remembered too that the absence of a right to send a substitute does not mean that a worker is necessarily an employee. It would in these circumstances be necessary to look at all the other terms and conditions of the relationship in order to decide. See *McManus v Griffiths* 1997 – personal service was required but Mrs McManus was still found to be self-employed.

In the *Express and Echo* case 1999 the right to send a substitute was fettered to the extent that the substitute had to be “suitable” and it is now accepted by the Revenue that such a clause is not unreasonably fettered. Suitable in this context really means suitably qualified and skilled to undertake the services. That said, there are always exceptions and in fact the Revenue's own internal manuals go further than the case law!

In recent IR35 cases the Revenue now argue on the basis of their interpretation of the Synaptek High Court appeal case that unless a substitute has been sent then they can simply treat any clause giving a right to substitute as one amongst many carrying little weight. As the Express and Echo case was heard at a higher Court (Court of Appeal) it takes precedence.

A final point on substitution concerns the fact that you can have both internal and external rights to substitution. Ideally your contract should have both. An internal right is where the services are re-allocated to the personal service companies own internal personnel (note that in most cases this is impossible as there is only you!) and an external right is where the personal service company has a right to send a substitute on its own behalf to carry out the services. An external right to substitute is considered to be stronger than an internal one.

Some relevant case law on substitution is Ready Mixed Concrete (South East) Limited v Minister of Pensions and National Insurance (1968) High Court, Global Plant Limited v Secretary of State for Health and Social Security (1971) High Court, Australian Mutual Provident Society v Chaplin (1978) Privy Council, McMenamin v Diggles (1991) High Court, Hall v Lorimer (1993) Court of Appeal, Express and Echo Publications Limited v Tanton (1999) Court of Appeal and Macfarlane and Skivington v Glasgow City Council (2000) Employment Appeals Tribunal, Synaptek Ltd v Young (2003 High Court.

## **MUTUALITY OF OBLIGATIONS (MOO)**

We are looking to see in your contract a lack of Mutuality of Obligations (MOO). MOO is a complex issue. Indeed so complex that until 2001 the Revenue advised its own Officers not to raise the issue of MOO unless the customer did as it was so complex!

Before there can be a Contract for Services (self-employment) or a Contract of Service (employment) both parties have to accept that they have obligations to each other. In the context of employment MOO can be explained by saying that, as a minimum there is a continuing obligation on the employee to provide his own work, and on the employer to provide work – or if there is no work at least to pay the employee. The Revenue has consistently played down the importance of MOO reducing it to the mere offer and acceptance of work. This is not what the case law says and the Revenue was criticised by Mr Justice Burton in the PCG Judicial Review case (2001) on its interpretation.

Most of the case law concerning MOO has resulted from employment law and the establishment of global or umbrella arrangements where it has been necessary to prove MOO in order to qualify for certain benefits. It is clear from the case law that the necessary elements of continuity and care and trust and confidence are characteristics of mutuality not just the offer and acceptance of work. There is a higher level of obligations and these must be obligations on both parties for MOO to exist. The most recent and perhaps the most important case was between Synaptek Limited and the Revenue (this was an IR35 appeal case where the General Commissioners had found that IR35 applied), which went to the High Court in March 2003. Here the Revenue has now accepted that MOO is a defining feature of

employment. If there is no MOO then the contract cannot be characterised as a contract of employment and so IR35 cannot apply.

Clearly it is important to agree the inclusion in a contract a clause to show a lack of MOO and indeed this is probably one of the easiest clauses to agree with the client and the agency if there is one. However although such a clause will carry a lot of weight it must be remembered that in all cases of deciding status it is the reality of the working relationship that matters and in the case of IR35 it is necessary to construct a hypothetical contract in order to decide. It would be very easy to say there can be no MOO between a typical IR35 contractor and his client especially where an agency is involved but deciding if there is MOO is more complicated than this. For example, if a client asks for a specific individual to work on something for the foreseeable future and he agrees then there is likely to be MOO. In the same way if someone is contracted to work on a specific project that finishes early but the engager is then obliged to find further work then there is MOO. In the Synaptek case MOO was found during the currency of the contract because the client was obliged to allocate work for Mr Stutchbury to do, and there was a four-week notice period.

The Synaptek case is the first case law on IR35 but does not constitute binding authority for the weight given to the various factors indicating employed or self-employed status as it was based not on these but on a point of law. It is still absolutely vital to have a clause in your contract stating a lack of MOO as careful analysis of all the case law shows that it is part of the “irreducible minimum” required to establish direct employment. Until the courts directly consider MOO in the context of IR35 in our opinion a genuine lack of mutuality of obligations is enough to show that IR35 does not apply.

The relevant case law on MOO is *Airfix Footware Ltd v Cope* 1978 EAT, *O’Kelly v Trust House Forte* 1983 Court of Appeal, *Nethermere (St Neots) Ltd v Gardiner* 1984 Court of Appeal, *McLeod v Hellyer Bros* 1987 Court of Appeal, *Clark v Oxfordshire Health Authority* 1997 Court of Appeal, *McMeechan v SOS for Employment* 1997 Court of Appeal, *Carmichael v National Power* 1999 House of Lords, *Montgomery v Johnson Underwood Ltd* 2001 Court of Appeal, *R (on the application of Professional Contractors Group and others) v IRC* 2001 High Court, *O’Murphy v Hewlett Packard* 2001 EAT and *Synaptek Limited v Mr Graeme Young (HM Inspector of Taxes)* 2003 High Court.

## **CONTROL**

We are looking to see in your contract a lack of the right of control. Control concerns the how, when, where or what is to be done. The more of these elements that your client cannot control, then the more likely you will not be found to be an employee. If there is no control then you cannot have direct employment. Control has always been a favourite of the Inland Revenue as a very strong indicator of employment and in our experience they will quote absolutely anything as being an indicator of control.

Clearly it is good news if you can control where you do the work. Being able to undertake some of the services from your own premises is very helpful. The same goes for when in that by being free to choose when you work or your own hours indicates a lack of control. A lack of control over what has to be done may be more

difficult unless you have set out a programme of works or have to deliver a specific project as opposed to part of it. Case law suggests that if you are an expert or highly skilled individual then control over how you do the work will be at least limited and probably not present.

The key here is to ensure wherever possible that the contract properly reflects the terms and conditions. For example many standard agency contracts stipulate a standard working week but if this is not the case then the contract should be amended. If the contract cannot be changed we recommend that you seek written confirmation about the true terms as set out in the template available on this site.

## **OTHER FACTORS**

The most common factors are briefly covered below but there are many other factors that may be pertinent to a particular occupation or contract that may be of significant importance in determining your status. These will of course be considered in any contract review.

### **Hiring helpers**

This is an overwhelming indicator of self-employment, which also points to you genuinely being in business on your own account.

### **In business on your own account**

To have a proper business organisation indicates self-employment. For IR35 many will not have the usual trappings of being in business like stock, premises or staff but they can still show the structure of a genuine business. This may take the form of an office at home, a website, being VAT registered, having business stationery, advertising, invoicing, taking out insurances. Having other clients particularly concurrently is most helpful.

### **Financial risk**

Many of the factors that serve to illustrate being in business also give support to financial risk, as these are clearly costs and risks that an employee would not have to bear. This is also true of the risk of bad debts or lack of work as in *Hall v Lorimer*. Obviously fixed price contracts clearly demonstrate financial risk and a chance to profit.

### **Intention of the parties**

The intention of the parties to have an independent relationship should always be taken into account. The Revenue persists in the view that this will only be considered in borderline cases although their manuals are contradictory. As with all factors your contract should contain an intention clause.

### **Freedom to offer services to others**

You should have the freedom to undertake services for others and exploit your skills in the market place as you see fit. Having other business streams is most helpful to show being in business so to have a clause setting out this freedom is important.

#### **Provision of equipment**

This is helpful where the need to provide equipment is necessary but in the case of a skills-only case may be of limited value.

**Employee type benefits**

It is always helpful to clearly state the lack of employee type benefits such as holiday pay, sick pay and pensions etc. They are status indicators.

**Basis of payment**

The case law does not support the Revenue's contention that hourly or daily rates indicate employment. This is because both employees and the self-employed can be paid by the hour or the day.

**Part and parcel or integration into the organisation**

This was once a favourite of the Revenue which case law does not support. The Revenue now recognises that it is of limited use. However some care needs to be taken following the Synaptek case. Although as previously stated this does not create precedent the General Commissioners clearly considered that Mr Stutchbury was integrated into the workforce. This is because he had a "Line Manager" and he often went to the aid of employees of other firms on the site. The time spent was included on his timesheet. The Commissioners found these as indicators of employment.

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