Case No: CH/2008/APP/0289

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IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION

Royal Courts of Justice
Strand
London WC2A 2LL

Monday, 24 November 2008

BEFORE:

SIR DONALD RATTEE

BETWEEN:

HER MAJESTY'S REVENUE & CUSTOMS

Applicant/Claimant

- and -

LARKSTAR DATA LTD

Respondent/Defendant

No representation provided

Approved Judgment

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1. SIR DONALD RATTEE: This is an appeal by Her Majesty's Revenue & Customs against a decision of the General Commissioners allowing an appeal by Larkstar Data Ltd against a determination by Her Majesty's Revenue & Customs of liability to income tax under PAYE regulations and social security contributions for the period of 6 April 2001 to 5 April 2003.

2. The relevant background facts can be stated fairly shortly. Larkstar Data Ltd, to which I will refer simply as Larkstar, is a company which describes its business as "the provision of computer consultancy services". One Mr Alan Brill is its sole director.

3. Technology Project Services International Ltd ("TPS"), is a company which acts as an agency for the engagement of contractors by a third company, Matra Bae Dynamics UK Ltd ("MBDA") which at the material time worked on defence missile systems and was engaged on a long project which required specialist computer services.

4. For the purpose of acquiring these services MBDA entered into agreements with TPS for their procurement.

5. Starting on 11 August 2000 Larkstar entered into a series of agreements with TPS for the provision of computer consultancy services to MBDA. Pursuant to those agreements Larkstar provided to MBDA the specialist services of Mr Brill, which he provided for MBDA at its premises. There was no direct contract between Mr Brill and MBDA. He was the person whom Larkstar provided for the purpose of fulfilling its contractual obligations to TPS.

6. However HMRC took the view that these arrangements were such as to fall within the anti-avoidance provisions contained in schedule 12 to the Finance Act 2000, dealing with income and corporation tax, and regulation 6 of the Social Security Contributions (Intermediaries) Regulations 2000, Statutory Instrument 727 of 2000 ("the Social Security Regulations"), dealing with national insurance contributions. These provisions together are commonly referred to as the IR35 legislation.

7. The Revenue served notices of determination and decision on Larkstar on the basis that the IR35 legislation applied.

8. The purpose of the IR35 legislation was explained by Robert Walker LJ, as he then was, in R (on the application of Professional Contractors Group Ltd and others) v Inland Revenue Commissioners [2001] EWCA Civ 1945 reported in 2002 Simon's Tax Cases at 165 as follows:

> "…to ensure that individuals who ought to pay tax and NIC as employees cannot, by the assumption of a corporate structure, reduce and defer the liabilities imposed on employees by the United Kingdom's system of personal taxation."

9. The IR35 legislation provides, so far as material for present purposes, as follows. Regulation 6 to the Social Security Regulations provides:

> **"6.** (1) These Regulations apply where –

(a) an individual ("the worker") personally performs, or is under an obligation personally to perform, services for the purposes of a business carried on by another person ("the client"),
(b) the performance of those services by the worker is carried out, not under a contract directly between the client and the worker, but under arrangements involving an intermediary, and
(c) the circumstances are such that, had the arrangements taken the form of a contract between the worker and the client, the worker would be regarded for the purposes of Parts I to V of the Contributions and Benefits Act as employed in employed earner's employment by the client.
(3) Where these Regulations apply –
(a) the worker is treated, for the purposes of Parts I to V of the Contributions and Benefits Act, and in relation to the amount deriving from relevant payments and relevant benefits that is calculated in accordance with regulation 7 ("the worker's attributable earnings"), as employed in employed earner's employment by the intermediary, and
(b) the intermediary, whether or not he fulfils the conditions prescribed under section 1(6)(a) of the Contributions and Benefits Act for secondary contributors, is treated for those purposes as the secondary contributor in respect of the worker's attributable earnings.
And Parts I to V of that Act have effect accordingly."

10. The corresponding provisions, so far as material, of schedule 12 to the Finance Act 2000 are as follows:

> "(1) This Schedule applies where:
> (a) an individual ("the worker") personally performs, or is under an obligation personally to perform, services for the purposes of a business carried on by 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 sub-paragraph (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."

11. I need not refer to the provisions of the 2000 Act setting out the consequences of schedule 12 applying. They are not in issue. Suffice it to say that, as with the Social Security Regulations, they treat the worker as employed by the intermediary. I am only concerned on this appeal, as were the General Commissioners, with the question of whether schedule 12 does apply to the present case. It is common ground that there is no relevant difference for present purposes between the terms of Regulation 6 of the Social Security Regulations and Schedule 12 to the 2000 Act.

12. The General Commissioners rejected the view of the Revenue that the IR35 legislation did apply in the present case. They concluded that, had Mr Brill, "a worker" for the purpose of the IR35 legislation, provided the services he did to MBDA, "the client" for the purpose of the legislation, under a direct contract with MBDA, he would properly have been regarded as an independent contractor with, and not an employee of, MDBA, with the result that the IR35 legislation did not apply.

13. The Revenue appeals to this Court against that decision on four grounds set out in its grounds of appeal. The grounds of appeal are:

> "The General Commissioners erred in law in that they
> (1) misdirected themselves in law and in particular having identified the correct question they did not answer it and applied the wrong test in determining whether or not the arrangements would have amounted to a contract of or for service if they had been entered into directly with the client.
> (2) misdirected themselves in law in their approach to the issues of
> (a) control (b) mutuality of obligation and (c) the relevance of a number of considerations to the question they had to determine.
> (3) took into account irrelevant considerations and based their decision on a number of findings of fact which were either not supported by the evidence or inconsistent with other findings of fact.
> (4) reached a conclusion which was not open to them on the evidence before them."

14. In the Case Stated by the General Commissioners they set out facts found by them in paragraph 5. I shall refer to some of those findings which are as follows.

15. (1) On 11 August 2000 Larkstar entered into the first agreement with TPS for the provision of consulting services to MBDA.

16. (2) This was followed by four further successive such agreements. In fact the agreements were each for a period of six months immediately following the previous agreement, making a total of two and a half years during which Mr Brill's services were provided to MBDA pursuant to those agreements.

17. (3) Remuneration to be paid by MBDA was based on an hourly rate.

18. (4) There was no provision in the contracts for sickness, holidays, pensions, bonuses or employee's rights and privileges, such as car parking, sports facilities or medical services.

19. (5) An ongoing project known as ASRAAM, being worked on by MBDA, was the sole purpose of the contracts entered into between Larkstar and TPS.

20. (6) The work to be done by Mr Brill had to be performed exclusively at MBDA's premises for security reasons.

21. (7) Mr Brill was encouraged to work during MBDA's core hours for the purpose of co-ordinating his work with that of others, but he was free to decide when to work outside these core hours.

22. (8) Once Mr Brill and MBDA had negotiated the next stage of the ASRAAM project no control over how Mr Brill did his work was exercised by MBDA.

23. (9) Each of the five contracts allowed a substitute to be provided for Mr Brill, but the overriding security arrangements required substitutes to undergo procedures as rigorous as contractors and in practice that did not happen.

24. (10) Each of the five contracts required Mr Brill to provide his own equipment, but the overriding security arrangements required him to use MBDA's on-site equipment.

25. (11) Mr Brill was deliberately set apart by MBDA from their company's structure so that he could independently analyse and criticise and test their systems so as to further the success of the project. His professional independence was what MBDA hired. Without it there was no point in hiring him.

26. (12) He occupied no post and had no title. His badge described him as a contractor.

27. (13) When the project ended, or, if it had been terminated prematurely, the engagement ended, there was no obligation on MBDA to provide work outside or beyond each contract and, if it had been offered, no obligation on Mr Brill to do it.

28. (14) Mr Brill was free to work for other clients but did not in fact do so.

29. (15) The engagement could be terminated (i) at the end of each contract without notice (ii) by either party giving the other one month's notice within the contract period and (iii) at the end of the project without notice, as in fact happened.

30. (16) Mr Brill had no financial risk apart from loss of income (i) on premature termination and (ii) on having to redo unsatisfactory work at his own expense.

31. (17) Larkstar's involvement with MBDA ended on or about 31 October 2003.

32. On this appeal the Revenue submits that I should set aside the General Commissioners' conclusion because they misdirected themselves in law in various respects and made findings of fact unsupported by the evidence. I shall consider each of the four grounds of appeal in turn.

33. Ground 1 (and I re-quote it for purposes of convenience) is:

> "The General Commissioners misdirected themselves in law. In particular having identified the correct question they did not answer it and applied the wrong test in determining whether or not the arrangement would have amounted to a contract of or for service if they had been entered into directly with the client."

As developed by Mr Nawbatt for the Revenue, the substance of its complaint here is that the General Commissioners purported to answer the question they had identified by reference to the actual facts found by them without carrying out the process required by law of constructing a hypothetical contract between Mr Brill and MBDA.

34. As authority for the correctness of this latter process Mr Nawbatt relied on various dicta in other cases and in particular on a passage in the judgment of Park J in Usetech Ltd v Young (HM Inspector of Taxes) 76 Tax Cases 811. In paragraph 9 of his judgment, after setting out the relevant provisions of paragraph (ii) of schedule 12 to the Finance Act 2000, Park J said this:

> "A more general point of construction is worth spelling out at this stage. The conditions of sub-paragraphs (a) and (b) involve an analysis of the actual facts and legal relationships, but when that analysis shows that those two sub-paragraphs are satisfied sub-paragraph (c) involves an exercise of constructing a hypothetical contract which did not in fact exist, and then inquiring what the consequences would have been if it had existed. There may be room in some cases for dispute about what the hypothetical contract would contain."

35. While I agree that this is an accurate analysis of the process to be carried out, I am afraid I fail to see any real substance in the Revenue's objection to the Case Stated on this ground. It is true that the General Commissioners did not so express the task they were performing, but it is, in my judgment, clear from the Case Stated that the General Commissioners were considering whether, on the facts they have found, including the terms of the actual contracts between Larkstar and TPS, the relationship between Mr Brill and MBDA would have been one of master and servant or one of independent contractors, had Mr Brill been doing what he did in the way he did and in the circumstances he did under a contract between himself and MBDA.

36. Although it is no doubt true that the General Commissioners could have described their process in more precise legal terms, such as those used by Park J and other judges, I am not satisfied that the process they did adopt was not that required by paragraph 12(1)(c) of schedule 12 to the 2000 Act. So, I reject this first ground of appeal.

37. Ground 2 is as follows:

> "Misdirected themselves in law in their approach to the issues of (a) control (b) mutuality of obligation (c) irrelevance of a number of considerations to the question they had to determine."

38. As to (a), the question of control, Mr Nawbatt made the following submissions:
(1) The General Commissioners failed to have regard to the dictum of Lord Parker, CJ, in Morren v Swindon & Pendelbury Borough Council [1965] 2All ER 349, to which the General Commissioners had been referred by the Revenue. The dictum concerned, directed to the identification of a contract of service as opposed to a contract for services, is as follows:

> "The cases have over and over again stressed the importance of the factor of superintendence and control, but that it is not the determining test is quite clear. In *Cassidy v Minister of Health*, Somervell LJ

> referred to this matter, and instanced, as did Denning LJ in the later case of *Stevenson, Jordan & Harrison v MacDonald & Evans*, that clearly superintendence and control cannot be the decisive test when one is dealing with a professional man, or a man of some particular skill and experience. Instances of that have been given in the form of the master of a ship, an engine driver, a professional architect or, as in this case, a consulting engineer. In such cases there can be no question of the employer telling him how to do work; therefore, the absence of control and direction in that sense can be of little, if any, use as a test."

39. The Revenue submit that the statements by the General Commissioners in paragraph 9(b)(iv) of the Case Stated that the fact that Mr Brill was a consultant and that there was no control by MBDA as to how he did his work indicated that he was independent, without any reference to Lord Parker, CJ's dictum, show that the General Commissioners took no proper account of the principle enunciated in that dictum. I think there is force in this submission and it is supported by the unfortunate fact that the General Commissioners appear to have overlooked the fact that the Revenue representative appearing before them had referred them to authority in the form of decided cases - see paragraph 8 of the Case Stated. That paragraph reads as follows:

> "At the conclusion of the parties' submissions, and having regard to the fact that none of the cases in Bundles A and B had been referred to, the Chairman of the Commissioners asked the Inspector whether he wished to draw attention to any of the reported cases. The Inspector declined."

40. This is quite wrong and the error in the draft case was drawn to the attention of the clerk to the General Commissioners with a reminder that the Inspector had referred to no less than nine authorities and provided the clerk with a copy of his typed speaking brief during the hearing. If, as appears to be the case, the General Commissioners took no account of the authorities to which they were referred, one can well understand how they may have come to misdirect themselves on the law, and I accept that they did in this respect.

41. (2) Mr Nawbatt for the Revenue relied on another unsatisfactory feature of paragraph 9(b)(iv) of the Case Stated and the General Commissioners' findings on the question of control, and that is that it refers back to the finding of fact in paragraph 5.6 that:

> "Mr Brill was encouraged to work during MBDA's core hours"

when in fact it is apparent from paragraph 7(4)(viii) of the Case Stated that Mr Brill's own evidence was to the effect that he was required to work 37 hours a week including the core times of 9.30am to 12 noon and 1.00pm to 4.00pm. There was no other evidence to the contrary save perhaps a document that did not come into existence until 2005, long after the relevant period, dealing with relations between MBDA and what were called in the document their "sub-contractors".

42. Bearing in mind the General Commissioners' statement in paragraph 9(a)(iv) of the Case Stated that they found Mr Brill's evidence to be convincing and to be preferred in

all cases of apparent conflict, I find it impossible to see how the finding that Mr Brill was only encouraged as opposed to required to work the core hours can be justified by the evidence. I accept Mr Nawbatt's submission that, had they made a finding in accordance with Mr Brill's evidence that he was required to work these hours, they might well have taken the view that such finding pointed to employment rather than, as they say in paragraph 9(b)(iv) "being neutral as between employment and independent sub-contracting."

43. As to ground 2(b), that the General Commissioners misdirected themselves in law on the issue of mutuality of obligation, Mr Nawbatt made the following submissions: (1) the General Commissioners considered the issue of mutuality of obligation in paragraph 9B 10 and 9(b)(xii) of the Case Stated, which I shall read. Paragraph 9(b)(x) is as follows:

> "Whether the worker works continuously for the client or whether the worker has a series of engagements. Throughout Mr Brill worked only on the ASRAAM project but under a series of five contracts. When the project ended, or if it were terminated prematurely, his engagement would end. There was no obligation on the employer to provide work outside or beyond each contract. This indicates that he was independent."

44. Then paragraph 9(b)(xii) under the heading "Whether the client is obliged to offer work and whether the worker is obliged to do the work", reads as follows:

> "There was no obligation either way. The obligations of the parties were contained in and confined by the contract. This indicates that he was independent."

45. (2) Mr Nawbatt submitted that the General Commissioners misdirected themselves in law in directing themselves that the absence of any obligation in one six-month contract to offer work to Mr Brill after the end of that contract indicated that Mr Brill was not employed by MBDA. In so finding the General Commissioners completely ignored statements of principle by the Court of Appeal in Cornwall County Council v Prater [2006] EWCA Civ 102. The issue in that case was whether Mrs Prater, who during a ten-year period, had had a series of work contracts with the council to teach pupils unable to attend school, was, by those contracts, an employee of the council or an independent contractor.

46. At paragraph 40 of the transcript Mummery LJ said this:

> "To sum up, the legal position between the Council and Mrs Prater was as follows.
> (1) During that period 1988 to 1998 Mrs Prater had a number of work contracts with the Council. The issue was whether or not they were contracts of service. If they were, she enjoyed continuity of employment, notwithstanding the breaks between the contracts.
> (2) Under the contracts Mrs Prater was engaged and was paid to teach individual pupils unable to attend school.

> (3) There can be no doubt that, if she was engaged to teach the pupils in a class, collectively or individually, at school under a single continuous contract to teach, Mrs Prater would have been employed under a contract of service.
> (4) It makes no difference to the legal position, in my view, that she was engaged to teach the pupils out of school on an individual basis under a number of separate contracts running concurrently or successively.
> (5) Nor does it make any difference to the legal position that, after the end of each engagement, the Council was under no obligation to offer her another teaching engagement or that she was under no obligation to accept one. The important point is that, once a contract was entered into and while that contract continued, she was under an obligation to teach the pupil and the Council was under an obligation to pay her for teaching the pupil made available to her by the Council under that contract. That was all that was legally necessary to support the finding that each individual teaching engagement was a contract of service."

47. Longmore LJ referring to a submission that:

> "There was no or no sufficient "mutuality of obligation" which was part of the irreducible minimum which had to exist before a contract could be a contract of employment."

said this at paragraph 43 and following of the transcript:

> "43. I cannot accept this submission. There was a mutuality of obligation in each engagement; namely that the County Council would pay Ms Prater for the work which she, in turn, agreed to do by way of giving tuition to the pupil for whom the Council wanted her to provide tuition. That to my mind is sufficient "mutuality of obligation" to render the contract a contract of employment if other appropriate indications of such an employment contract are present.
> 44. If Ms Prater had been seeking to prove that there was a long-term or global contract of employment, the fact that the Council were not obliged to offer her any work and that, if they did offer her work, she was not obliged to accept that offer would, no doubt, mean that no such long-term or global contract existed. But Ms Prater put forward no such argument. She was only saying that the individual commitments, or engagements, once entered into, constituted contracts of employment. The Employment Tribunal held that this was indeed the position in paragraph 14 of their decision and I can detect no error of law in their conclusion."

48. (3) Those statements of the relevant law seem to have been ignored by the General Commissioners, because what they say in paragraph 9(b)(x) and (xii) of the Case Stated is quite inconsistent with them.

49. (4) In paragraph 9(c) of the Case Stated the General Commissioners indicate that they regarded the alleged lack of mutual obligation as one of the most compelling factors indicating, in their view, independent contracting.

50. (5) This conclusion is vitiated by the clear misdirection by the General Commissioners of themselves on the relevant law.

51. Mr Stafford on behalf of Larkstar, the respondent on this appeal, argued that, and I quote from his skeleton argument:

> "Seen in the context of the findings of fact made by the General Commissioners, it can be seen that the point which they were making was not that there was no mutuality of obligation during the currency of any of the fixed term contracts. Indeed, the explicit words of the finding of fact and of paragraph 9B(l0) & (12) reveals this to be so. Instead, the General Commissioners were drawing a contrast between project work and employment. All employee who is given a task remains employed even when that task IS completed, and his employer is generally going to look for something else for him to do. If something is found, then an employee cannot simply turn his nose lip at it. By contrast, someone who is only engaged for the duration of a project cannot expect an entitlement to be offered other work, nor can the end-user be required to find other work."

52. I am afraid I do not find this provides any answer to the Revenue's argument. The relevant question for the General Commissioners was whether Mr Brill would have been employed by MBDA during the two and a half years of the hypothetical contract or contracts between them. The decision of the Court of Appeal in Prater seems to me clearly to indicate that the fact relied on by the General Commissioners, namely that MBDA would have been under no obligation to offer further work outside the terms of these contracts, is irrelevant to the question in issue. Thus I accept Mr Nawbatt's submission that here one finds a clear misdirection of themselves by the General Commissioners as to the law.

53. I turn then to (c) of ground of appeal (2), namely that the General Commissioners misdirected themselves in their approach to the relevance of a number of considerations to the question they had to determine. Some of the points relied on by Mr Nawbatt under this heading were the following.

54. Mr Nawbatt's first point relates to the provisions for termination on one month's notice of each contract between Larkstar and TPS which the General Commissioners assumed would be in the hypothetical contracts between Mr Brill and MBDA. The General Commissioners find this to be one of the most compelling indicia of a contract for services rather than employment. The Revenue submits that this was again a result of a misdirection by the General Commissioners of themselves on the relevant law.

55. Mr Nawbatt points out that in McManus v Griffiths 70 Tax Cases 218 at page 232 Lightman J expressed the view that a condition for termination on three months' notice was no indication of whether the contract was of service or for services. In Morren v Swindon & Pendelbury Borough Council [1965] 2All ER349 at page 351 Lord Parker, CJ considered that a provision for one month's notice indicated a contract of service. The General Commissioners do not seem to have taken account of either of these authorities.

56. While I see force in the Revenue's argument, I am not convinced that it is fair to say that the General Commissioners misdirected themselves in law on this point. It follows from the apparent conflict between the dicta cited by Mr Nawbatt, to which I have referred, that there does not seem to be any clear law on the point.

57. The remainder of the considerations referred to in ground (2)(c) of the grounds of appeal constitute a list of factors which the General Commissioners regarded as indicia of a contract for services, or rejected as indicia of a contract of service. In each case the Revenue submits that the General Commissioners erred in the significance they attached to these factors. I do not believe it helpful to go through the list.

58. I have already indicated that I accept that the General Commissioners did misdirect themselves on the law in relation to their consideration of what they found to be the important questions of control and mutuality of obligation and made one finding of fact in relation to the former question, namely that Mr Brill was only encouraged to work the core hours, unjustified by the evidence before them.

59. It follows in my judgment that the appeal must be allowed and I am afraid the matter must be remitted to the General Commissioners to be re-heard *de novo* by a differently constituted panel, for I cannot be satisfied that they would have reached the same conclusion as they did, had they not made the errors of law and unjustified finding of fact which I have identified.

60. In these circumstances it does not seem appropriate to express a view on the Revenue's further list of matters under ground of appeal (2)(c) as to which I do not find any point of law on which I can say the General Commissioners misdirected themselves.

61. Particularly having regard to the comparatively small amount of money at stake on this appeal it is in my opinion unfortunate that there has to be all the expense and delay of a re-hearing by the General Commissioners, but I have to accept Mr Stafford's submission that I cannot myself properly determine questions of fact central to Larkstar's appeal. Hence submissions before me were properly directed only to particular criticisms of the decision made by the General Commissioners and not to the question of whether in fact Mr Brill would, under the hypothetical contract, have been employed or self-employed.

62. That was consistent with the fact that the Revenue in its Notice of Appeal indicated that the only order sought by it on this appeal is an order "setting aside" the decision of the General Commissioners. They did not indicate that they sought any alternative order.

63. I have not yet said anything about the Revenue's 3rd and 4th grounds of appeal. Mr Nawbatt for the Revenue accepted rightly that ground (3) really adds nothing to ground (2). As to ground (4), namely that the General Commissioners erred in law and that they reached a conclusion not open to them on the evidence before them, the only additional argument relied on by Mr Nawbatt was directed at paragraph 9(d) of the Case Stated in which the General Commissioners said:

> "We were invited to apply to the facts of this casethe analogy of a surgeon employed by a hospital. He has complete professional freedom, but is nevertheless an employee. We prefer the analogy of a householder engaging a builder. However many the additions or amendments to the original contract, and however pernickety or demanding the householder, the builder remains an independent contractor. And so it was in this case."

64. Mr Nawbattt criticises the analogy of a builder chosen by the General Commissioners and submits that it is so inept as to indicate that the General Commissioners must have misdirected themselves in law. I agree that the analogy is certainly not a happy one, but I do not think that the choice of it by the General Commissioners would of itself have been sufficient to establish an error of law by them.

65. For the reasons I have given, however, I shall allow the Revenue's appeal and remit the matter to the General Commissioners for re-hearing by a different panel.

66. As no one is here representing either party what I propose to do is to make the order I have indicated, order that the respondent shall pay the Revenue's costs of this appeal to be the subject of a detailed assessment in the absence of agreement, and I will direct that either party may make an application to me within the next 28 days (such application to be in writing via the Chancery Listing Office, as I shall not be sitting any more this term) to make some further order or to change the wording of some order I have indicated I shall make - not, of course, an application to amend the judgment.

67. So, the order I make is that the appeal is allowed with costs, costs to be the subject of a detailed assessment in the absence of agreement, and the subject matter of the appeal shall be remitted to the General Commissioners for re-hearing by a differently constituted panel from the panel that heard the appeal on the previous occasion.