NATIONAL INSURANCE CONTRIBUTIONS – intermediary ("IR 35") – whether worker would be employee if there were a contract between the worker and the client – no

THE SPECIAL COMMISSIONERS

LIME-IT LIMITED - Appellant

- and -

THE COMMISSIONERS OF INLAND REVENUE - Respondents

Special Commissioner: DR JOHN F AVERY JONES CBE

Sitting in London on 2 October 2002

David Smith, Accountax Consulting Limited, for the Appellant

Barry Williams, London Region Advocacy Unit, for the Respondents

DECISION

1. This is an appeal against a Notice of Decision dated 11 February 2002 that the Appellant is liable to pay primary and secondary Class 1 National Insurance contributions in respect of Miss Lisa Fernley's earnings in respect of a particular contract under what has become known as the "IR35" legislation. The Appellant was represented by Mr David Smith of Accountax Consulting Limited, and the Commissioners of Inland Revenue by Mr Barry Williams.
2. In outline, Miss Lisa Fernley is the sole shareholder and director of the Appellant company, a new IT company formed on 4 April 2000 providing services and in connection therewith supplying both hardware and software. The Appellant's brochure describes the services it offers as: "IT solution design, implementation and support; IT support services; networking services; system tuning and optimisation; web design services; hardware and software sales." On 17 April 2000 (although the signature page indicates that it was executed by the parties on 2 and 8 May 2000 respectively) the Appellant contracted with Executive

Recruitment Services plc (ERS), an agent providing expert help and assistance to "End-users", the contract naming Alenia Marconi Systems (Marconi) as the End-user. The issue is whether, if the Appellant and ERS had not existed so that there was a direct relationship between Miss Fernley and Marconi, she would be an employee.

3. I heard evidence from Miss Fernley, and also from two officers of the Inland Revenue who had been concerned with the case, Mrs Wenn and Mr Justin. The Appellant, as appears from the correspondence, was unhappy with the Revenue's handling of the case and Mr Justin produced a lengthy note saying that he was not happy either with the way the case had been handled, and, with the guidance currently available, he would have tackled the situation differently, for which he apologised to the Appellant. In particular when he gave his initial opinion that IR 35 applied he was working on new unpopular legislation before Royal Assent finding himself swamped with work and operating under guidance that then concentrated on the documents without suggesting that he should have a meeting with, or obtain more information from, the Appellant and the End-user. Since the Appellant has been critical of the Revenue I should also record that when later the Revenue asked to meet Miss Fernley she refused the request. I appreciate Mr Justin's frankness in preparing this note, as I am sure the Appellant does, but his handling of the case is not ultimately relevant to the decision I have to make.
4. Schedule 1 to the contract between the Appellant and ERS describes the work as follows:

   "The project: to organise and manage PC desktop support within AMS Dynamics Division using a combination of permanent staff and contract resources to achieve measured improvements in quality of service and service level and report weekly to the end user on progress.

   Manage planning, implementation and migration to Microsoft Exchange email system

   Plan and implement remote access solution for mobile users.

   Produce research and plan for migration to Microsoft Windows 2000

   Site of Supply: Borehamwod/Stanmore or such other sites of the Client [not a defined expression but obviously referring to Marconi] or the Supplier [the Appellant] as may be agreed as expedient from time to time for performance of the Services."

   Schedule 2, headed "Term of Supply", is as follows:

   "Term of Supply from 10 April 2000 to 10 April 2001 (estimated date for completion of the project) or such alternate date as may be agreed from time to time by the parties as the date of completion of the project (end date) subject to the termination provisions in clause 4 [which should be clause 3, permitting termination on reasonable notice in various circumstances and on breach of the contract].

   1. The Agent [ERS] will pay the Supplier a fee at the rate of [the figures have been blanked out in my copy] per hour (plus VAT where applicable) [] per hour for overtime.

2. The Supplier shall provide the required services for 37 hours per week being the estimated number of hours per week for completion of the project within the contract term or such hours as are reasonably requested by the Client for the project.

3. Payment will be made against the Agent's timesheets which have been authorised by the Client, together with the Supplier's invoice."

5. Thus the work is for specific projects, such as organising and managing (rather than providing) a computer support function, introducing a new email system, organising remote access, and changing to Windows 2000. These projects were expected to take one year with the Appellant (meaning Miss Fernley as the only employee) working an estimated 37 hours per week at an hourly rate, but the contract would end on completion of the project.
6. Another relevant term of the contract is that there was a right of substitution that Miss Fernley negotiated and was not included as a standard condition, which is demonstrated by the reference to "Client" whereas the rest of the contract refers to the "End-user".

"In the event that the Supplier finds itself unable to provide the whole or any part of the Specified Services for whatever reason, the Supplier shall offer the Client a substitute ("the Substitute Supplier") of equivalent expertise to work in the Supplier's place. The Client has the right to refuse to accept the Substitute Supplier on any reasonable grounds. If the Client finds the Substitute Supplier acceptable, the Supplier shall provide an overlap period of up to (ten) working days during which time the Supplier shall ensure that the Substitute Supplier fully understands the requirements of the Client and progress made in providing the Specified Services. The Supplier shall not charge the Client any extra sum for this overlap period. Thereafter, the Supplier shall continue to invoice the Client and shall be responsible for the payments and expenses of the Substitute Supplier. In the event that the Supplier cannot provide an acceptable Substitute Supplier, the Client is entitled to terminate this Agreement forthwith."

The drafting shows that considerable thought went into this clause, for example the Appellant being obliged to provide free overlap time. This is a right for the Appellant to substitute another person in place of the Appellant rather than a right for Miss Fernley to substitute another employee of the Appellant for herself. That contract contemplates that various employees work on the contract and it contains provisions in clause 4 for ERS to specify in advance to the End-user the number, qualification and experience, and rate of payment of the personnel. I presume that Marconi fixed the hourly rate on the basis that Miss Fernley would do all the work herself. This would explain the reference to her name in the purchase order (see paragraph 7 below). I am therefore doubtful whether another employee of the Appellant could be used without Marconi's agreement, although the right to substitute another supplier of "equivalent expertise" for the Appellant existed, subject to Marconi's right to refuse to accept the substitute on reasonable grounds. In fact this right of substitution was never exercised and Miss Fernley did all the work personally. Another term of the contract is that the End-user was not entitled to direct the Appellant to perform any task other than that identified or implicit in the specification.

7. The only evidence of the contract between ERS and Marconi is a purchase order dated 8 May 2000 (the date on which ERS signed the agreement with the Appellant) which stated "To supply the services of Lisa Fernely (sic) for the period 10/4/00 until 6/4/01 [note that the other contract specifies 10 April 2001 as the expected termination date]." The hourly and overtime rate is then stated. Miss Fernley had not seen this document at the time. It was obtained by the Revenue from Marconi and a copy provided to her by ERS was only later seen by her. The contract between the Appellant and ERS contains the provision "The Agent [ERS] shall conclude an agreement with each End-user to whom Supplier's [the Appellant] details are sent which reflects the terms of this Agreement." In the absence of any evidence from Marconi I shall presume that this provision was carried out and that the ERS-Marconi contract was on the same terms as the Appellant-ERS contract. Accordingly, giving effect to both contracts, I shall assume that, although the ERS-Marconi contract required Miss Fernley's services in accordance with the wording on the purchase order as the hourly rate was based on her dong the work, Marconi were bound by the clause allowing substitution of another person of equivalent expertise with the benefit of the arrangements for a hand-over period, subject to their right to refuse to accept the substitute on reasonable grounds.
8. Marconi terminated the contract without notice on 3 April 2001, a few days before it was due to terminate, which, as I am assuming that the ERS-Marconi contract conforms to the Appellant-ERS contract, was on 10 April 2001. Miss Fernley said that there had been no disagreement with Marconi but she understood that they had outsourced the whole of their IT function and so the Appellant's services were no longer required. This came as a surprise as she had been in process of negotiating a further year's contract for a further specific project.
9. Regulation 6(1) of the Social Security Contributions (Intermediaries) Regulations 2000, made under sections 75 and 76 of the Welfare Reform and Pensions Act 1999 and the Social Security Contributions (Intermediaries) Regulations 2000, provides:

> "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 [the Social Security Contributions and Benefits Act 1992] as employed in employed earner's employment by the client."

"Intermediary" is defined in Regulation 5 and it is common ground that the Appellant is an intermediary for this purpose. "Employed earner's employment" is defined in section 2(1) of the Social Security Contributions

and Benefits Act 1992 to include a person who is gainfully employed under a contract of service (which is not further defined).

10. Paragraph (a) of Regulation 6(1) is satisfied; Miss Fernley did in fact personally perform services for the purposes of a business carried on by Marconi. Paragraph (b) is also satisfied; the intermediary is the Appellant. The real issue in the case is paragraph (c) which requires one to ask whether, had the arrangements taken the form of a contract between Miss Fernley and Marconi, she would be regarded as employed under a contract of service. In other words, one ignores for this purpose the existence of the Appellant (and ERS) and concentrates on what is actually done by Miss Fernley for Marconi in accordance with the arrangements made with the other parties. I heard evidence from Miss Fernley but no evidence was called from Marconi. Miss Fernley explained that as they had outsourced their entire IT work there was now nobody there who could speak to what was actually done while the Appellant was working for them. While I fully understand the difficulty the Appellant faced, it would have been very helpful if the former IT Manager could have been a witness so that I could have heard from both parties to the hypothetical contract. In future cases on this legislation (and its income tax equivalent) the Special Commissioners will wish to explore at a preliminary hearing whether it is possible to obtain evidence from the client.
11. Miss Fernley gave evidence, all of which I accepted, that the Appellant was then a new small business with no other employees. There is now one employee. It has its own web-site and markets its services to local businesses. During the Marconi contract the Appellant worked for 4 other clients. Miss Fernley worked at one of Marconi's offices, and partly from her office at her home where there is a room containing four computers dedicated to the Appellant's business. The Appellant paid for any travel between Marconi sites. She was left to do the Marconi job on her own, reporting weekly informally on progress to the IT manager. She did not work alongside Marconi employees; there were no Marconi employees doing her type of work and nobody with her type of expertise. Nobody told her how to do the job and nobody controlled her work, other than no doubt checking her time sheets. She did not work a regular 37 hour week as envisaged by the contract; her work varied from nothing to 52.5 hours in a week with considerable variations from week to week. For example, the number of hours worked in consecutive weeks in May and June 2000 were 49.5, 28, 44.5, 20.5, 52.5, 33.5, 0 hours. She worked the hours needed to get the job done. She described this variation of hourly figures as typical of the pattern during the contract. She was not treated as a member of Marconi's staff. She had a security pass but it named the Appellant and said "contractor" on it and it was a different colour from the employees' passes. The Appellant (not Miss Fernley) was listed in Marconi's internal telephone directory, and she had an email address there. She did not benefit from other usual employee benefits such as holiday pay, sickness pay or the use of sports facilities. The Appellant purchased a lap-top computer with the same specification as those used by Marconi costing £1,600 specially for the job, but there was no contractual obligation on it to do so. The Appellant invoiced monthly at the hourly rate with payment due in 30 days. On at least one occasion the Appellant had difficulty in being paid. Miss Fernley wrote to ERS on 24 April 2001 reminding them about two overdue invoices for a total of £6,563.84. On 24 May 2001 she wrote again threatening to sue for the debt plus interest, listing the two invoices as both being dated 6 April 2001 and stated to be due for payment on 16 April (I am not clear why as both contracts say 30 days, but this may have been varied). She wrote

again on 5 June, which was two months after the date of the invoice. The invoices were finally settled with interest.

12. The case law test of whether someone has a contract of service is difficult. It is even more difficult to apply the case law to a hypothetical contract. I am unclear about the extent of applying the hypothesis in relation to other work. On the face of it the hypothesis does not apply to other work performed by the intermediary, but in determining whether the hypothetical contract is an employment contract one needs to take into account other work done by the worker, which will actually be performed by the intermediary perhaps partly by other workers. I understood Mr Williams to contend that other work should not be taken into account. Fortunately in view of my findings in relation to the contract in isolation I do not need to pursue this aspect in this case. Mr Williams made clear that the Revenue accepted the genuineness of the Appellant's business, and that the Appellant was not avoiding National Insurance contributions by rewarding Miss Fernley by dividends; this case was purely concerned with applying the legislation to a hypothetical contract. The basic test of whether someone is employed or self-employed is to ask whether a person is "in business on his own account" (*Market Investigations v Minister of Social Security* [1968] 3 All ER 732). In *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* [1968] 2 QB 497, 498 D MacKenna J listed three conditions for a contract of service to exist:

    "(i) The servant agrees that in consideration of a wage or other remuneration he will provide his own work and skill in the performance of some service for his master, (ii) He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control in a sufficient degree to make that other master, (iii) the other provisions of the contract are consistent with its being a contract of service."

13. A number of different factors for helping to determine this have been developed by the courts to determine whether a contract of service exists, as follows (I have not stated the authority for each one as they are well-known and were accepted by both parties):

    Control. Mr Smith contended that there was no control by Marconi as to the manner in which Miss Fernley carried out her activities. Mr Williams contended that control was not an important test where experts are concerned. The way the work was performed was that Miss Fernley planned the projects herself and then communicated the plan to Marconi. In addition if their server broke down she would need to go immediately to the premises where it was and fix it. She reported on progress informally to the IT Manager weekly. He was the person who checked that Marconi was getting value from the contract. She managed to fit in work for the Appellant's other clients when her presence was not required at Marconi by the nature of the project, informing the IT manager of her movements so that she could be contacted if necessary. The contract provides that the Appellant could not be required to perform any task other than those identified or implicit in the specification. I accept Miss Fernley's evidence that Marconi did not exercise any significant control as to the manner in which she carried out her activities, but, as Mr Williams contended, control may not be particularly important when one is dealing with an expert.

    Financial risk and ability to profit. Mr Smith pointed to the contractual limit of liability of £1m in the contract between the Appellant and ERS as showing that there was significant financial risk. Mr Williams pointed to the

fact that the work was charged at an hourly rate with overtime at a higher rate, as one expects for an employee. The only way for the Appellant to make more profit would be for more hours to be worked, which is exactly the same for an employee doing overtime. An hourly rate is indicative of employment, much more so than a fixed price contract, but there are self-employed who charge at an hourly rate. Mr Williams accepted the existence of the bad debt risk but said that employees also had to accept the risk of the employer's insolvency. There were some serious delays in payment of invoices, over two months delay on one occasion. The fact of invoicing and the 30 day (or even 10 day, if that is what was subsequently agreed) terms for payment, even ignoring the actual delays in payment, seem to me to point to self-employment. I presume that Marconi (assuming that they were responsible for the delays) did not keep its employees waiting for their salary. I do not think that the limit of liability in the contract is particularly important; employees, such as employed doctors, can incur liability too and are required to carry insurance.

Provision of equipment. Mr Smith points to the lap-top computer which the Appellant purchased for the Marconi job. Mr Williams said that there was no contractual obligation to provide this, and pointed to the desk and telephone she had at Marconi as slight indicators of employment. Miss Fernley said that it was more convenient to use her own computer equipment. It would be normal for her to down-load files from the lap-top to computers at Marconi. This factor does seem to me to point to self-employment. An employee does not normally provide a lap-top but a self-employed person may do so if it makes the work easier to do, regardless of any contractual requirement. I do not regard the provision of a desk and telephone at Marconi as particularly significant. The Appellant has an office including four computers at Miss Fernley's home.

Right to substitute. Mr Smith relied heavily on this provision. Although the right was never exercised it is not a provision which can be described as a sham. It was negotiated specifically at the Appellant's request. Although I did not have any evidence from Marconi there is no reason to suppose that they would not have been willing to pay the same rate for a substitute of "equivalent expertise" as the contract requires. Indeed it was very much in their interest that the Appellant would provide a free overlap period to inform the substitute about the state of the work. It seems to me that in the hypothetical contract with Miss Fernley, Marconi must be taken to have the benefit and burden of this provision. It is a strong indicator of self-employment. Indeed in *Express and Echo Publications Ltd v Tanton* (unreported 11 March 1999) the Court of Appeal held that where a person is not required to perform the work personally, as a matter of law the relationship could not be one of employment:

"…it is, in my judgment, established on the authorities that where, as here, a person who works for another is not required to perform his services personally, then as a matter of law the relationship between the worker and the person for whom he works is not that of employee and employer."

Mutuality of obligation. Mr Williams pointed to the difficulty of applying this test to a hypothetical contract. It seems to me that Marconi could require Miss Fernley to work 37 hours per week or for such hours as are reasonably requested and she could require payment for such work.

Personal factors. This test takes into account the number of separate engagements the person holds. *Hall v Lorimer* 66 TC 349 was concerned with numerous short-term engagements. Mr Williams contended that a series of short-term engagements which individually might have the appearance of employment might amount in total to self-employment He suggested that the longer the contract the less relevant are personal factors in determining status, and this was a one-year contract. But he recognised that an astute businessman may work for one favoured client because it was commercially advantageous to do so. It seems to me that the length of the contract is a slight pointer to employment.

Basis of payment, holiday and sick pay. Mr Williams contended that the obligation to work 37 hours a week pointed to an employment relationship. This is the normal working week for Marconi employees. There is no right to holiday or sick pay. Travel between Marconi's different locations was paid for by the Appellant and not reimbursed, as one would expect it to be for an employee. In practice Miss Fernley did not work a 37 hour week. The variations in the number of hours actually worked is more indicative of self-employment.

Termination of contract. The contract terminates when the work is complete; 10 April 2001 is described as the "estimated date for completion of the project." This would be an unusual feature of an employment contract and is a pointer to self-empoyment. The contract was in fact prematurely terminated by Marconi.

Part and parcel of the organisation. Mr Williams contended that Miss Fernley was integrated into the Marconi organisation, so that anyone meeting her would be unlikely to distinguish her from an employee. This does not seem to me to be the case. She had her own business cards; her security pass was different from an employee's, saying "contractor" and having the Appellant's name; she had a telephone extension under the Appellant's name in Marconi's internal directory, and an email address within the organisation; she could not use Marconi sports facilities.

Intention of the parties. Mr Williams submitted that this test was relevant only where the case was borderline or where the status is ambiguous. It is in any event difficult to see how to apply intention to a hypothetical relationship between two parties who never actually contracted with each other and consequently had no intentions. Even trying to infer intentions is difficult. As a minor example, the fact that the parties contract to allow VAT to be added to payments might indicate that they did not intend an employment relationship. Here the Appellant-ERS contract provides for VAT but since that is a contract between two companies it does not say anything about how different parties would view the hypothetical contract.

14. The pointers against the hypothetical contract being a contract of service are that Marconi contracted for particular projects. The end-date and the number of hours were both estimates of the time needed to complete those projects. Miss Fernley did not work a regular pattern of hours; the hours were dictated by the requirements of the work. The Appellant could not be required to do work outside the specification. The Appellant purchased a lap-top with a particular specification specially for use in the job, although there was no obligation on them to do so. The payment terms were 30 days after invoice and they suffered delays in being paid in the way that businesses do. There was a right for the Appellant to

substitute another supplier. Miss Fernley did not work alongside any other Marconi employees as part and parcel of the Marconi organisation. During the Marconi contract the Appellant operated as a normal small business with its own office working for four other clients.

15. The pointers towards the hypothetical contract being a contract of service are that the contract provides for a fixed number of hours weekly at an hourly rate for a one year contract. No doubt this is the aspect that Mr Justin primarily focussed on. The reality of the hours worked is very different from the contract, demonstrating the necessity of looking beyond the terms of the contract. The element of financial risk is low when payment is made on this basis, but the risk of delay in payment and bad debts is there. The Marconi purchase order refers to Miss Fernley doing the work personally but this is explained by the fact that the hourly rate was fixed with her expertise in mind, and in my view is not contrary to the right of substitution.
16. In assessing this evidence I bear in mind that I have heard no evidence from Marconi and it is always possible that the Appellant may be emphasising factors favourable to them. But even allowing for this possibility, and standing back and looking at all the factors there is very little to suggest an employment relationship. In essence Marconi was contracting for a particular IT job from a small business in the way one would expect an IT consultant to be engaged. In my view on the hypothesis that Miss Fernley had contracted directly with Marconi she would not have been employed under a contract of service; she would have been in business on her own account.
17. Accordingly I allow the appeal. Mr Smith said that he reserved the right to apply for costs, while recognising the limited jurisdiction of the Special Commissioners to award costs. If he wishes to pursue this he should apply to the Clerk to the Special Commissioners within 21 days of the date of release of this decision for a further hearing limited to the issue of costs.

DR JOHN F. AVERY JONES
SPECIAL COMMISSIONER

SC 3027/02
Authorities referred to in skeletons but not in the decision
Montgomery v Johnson Underwood 2001 EWCA Civ 318
Carmichael v National Power [1999] 4 All ER 879
WHPT Housing Association v Secretary of State for Social Services [1981] ICR 737
Battersby v Campbell [2001] STC (SCD) 189
FS Consulting v McCaul [2002] STC (SCD) 138
Morren v Swinton and Pendlebury Borough Council [1965] 1 WLR 576
Nethermere (St Neots) Ltd v Gardiner [1984] ICR 612
Bank voor Handel en Scheepvaart v The administrator of Hungarian Property 35 TC 311
Massey v Crown Life Insurance [1978] 2 All ER 576