

## Experts slam logic underlying the HMRC IR35 tool



HMRC's IR35 tool has been branded 'meaningless', 'wholly unfit for purpose' and in certain circumstances a risk to contractors, by a panel of IR35 experts.

Having [examined the underlying logical structure and algorithm of the tool](#), ContractorCalculator explained its inner workings to three independent experts on IR35. The feedback was highly critical.

- HMRC's tool deviates dangerously from case law
- It has no legal weight due to the omission of key tests of employment
- It threatens to encourage wishful thinking amongst contractors, placing them at risk
- The tool ignores circumstance, which is critical to determining IR35
- Experts ultimately branded HMRC's tool 'counterproductive and retrograde'

### Who are our experts?

- Duncan Strike (ACA FCCA), director of specialist contractor accountancy firm [Intouch](#).
- Jason Piper, senior manager of Tax and Business Law at the Association of Chartered Certified Accountants ([ACCA](#)).
- Martyn Valentine, director of [The Law Place](#), a legal consultancy specialising in IR35, contract reviews and employment issues.

### What did we show them?

ContractorCalculator conducted an extensive analysis of HMRC's tool's underlying structure and algorithm. This included analysing the underlying blueprints and every possible outcome, and dissecting the key factors contributing to the judgments provided by the tool.

The findings showed that HMRC had adopted an approach contrary to employment case law practice, whereby contractors could achieve a pass without having to consider essential IR35 factors. We presented our 14-page review to the experts for discussion.

## Where is mutuality of obligation?

The glaring omission from HMRC's tool is any reference to '[mutuality of obligation](#)' (MOO), one of the key tests of employment. For the experts, this significantly undermines the credibility of the tool.

"The decision to ignore MOO renders HMRC's tool wholly unfit for purpose," comments Valentine. "In fact it's dangerous in that it ignores the fundamental tests of employment."

"HMRC doesn't believe that MOO is relevant to IR35 and its omission is another example of HMRC trying to impose its narrow view [of IR35] on the world," adds Strike. "The Revenue doesn't want it, doesn't understand it and wants to be able to ignore it - so it has. The only problem for HMRC is it now means its tool has no credibility."

## Is mutuality of obligation beyond HMRC's capabilities?

Piper suggests that MOO, accepted as the most difficult test of employment to apply, may have been too complex for HMRC to evaluate with its simple binary tool: "It's a very difficult thing to pin down. HMRC's tool is binary, whereas IR35 is much more of an analogue test, and MOO in particular is subject to various shades of interpretation."

Valentine, however, believes some minor changes could have lent far more credibility to the tool: "Will the engagement end after the project is complete or is it a fixed term engagement? This is one of a few basic questions concerning MOO that HMRC could have asked to make for a far more thorough evaluation.

"Eliciting MOO in an engagement shouldn't be unduly difficult, but HMRC appears to have ignored its own Employment Status Manual which acknowledges that the tests for employment status often overlap."

## HMRC's substitution 'golden pass ticket' puts contractors at risk

Experts agree that an unfettered [right of substitution](#) alone can warrant an IR35 pass in some circumstances, but warn that HMRC's willingness to issue passes based on one answer to a multi-choice questionnaire could encourage misuse or misunderstanding within the sector.

Strike warns of a [regression back to the days of 'sham' contracts](#), with contractors agreeing to contracts containing false substitution clauses that exist purely to circumvent IR35:

"Contractors could fall into the trap of believing an agency has a contract that gets them outside of IR35 simply because it has a substitution clause, whereas in reality HMRC would argue the clause is a sham because the end client wouldn't agree."

"A contractor may erroneously believe that they pass IR35 off the back of having a right to substitute when in fact all the other indicators may suggest that they are employed," adds Valentine. "It encourages wishful thinking and puts contractors at risk.

"HMRC has created a chance for those who wish to engage in window dressing to do so, and may encourage some agencies to flag up substitution clauses as a way of operating outside IR35. Ultimately, it's counterproductive and retrograde."

## IR35 experts label HMRC's tool 'meaningless'

Piper also points out that tribunal judges have made it very clear that they will be looking closely at what happens 'on the ground' during the contract to establish IR35 – both the correct method and an entirely different one to that adopted by HMRC.

Failure to align with case law isn't the only factor rendering the tool useless. Ultimately, given the subjectivity of its questions, Strike says it doesn't matter whether you pass or fail:

"Any opinion of whether you are under the control of the client is purely subjective, and therefore quite capable of being challenged at any point by somebody else. An objective test cannot be met with that level of subjectivity and retain its value."

## HMRC's tool fails to judge status on individual merit

Experts are unanimous that another key failing of HMRC's tool is its insistence on judging every contractor on the same basis. Questions and answers provided don't offer anywhere near enough insight into each contractor's engagement.

"The main problem is that the questions HMRC poses ignore the reality of how contractors operate and how projects run in practice," notes Valentine. "Once again the taxman has decided to take an unrealistic approach to employment status."

“It’s simply inadequate to apply a Q&A test to an IT consultant and then use the same test for an oil and gas worker, when they work in entirely different circumstances and environments” adds Strike. “The questions are far too general, with HMRC oversimplifying the issues to apply them on too broad a landscape. Each question and answer needs to consider factors such as industry and skillset.”

## Failed HMRC’s tool? Seek a second opinion

Strike continues: “The intention of the test was to provide clarity. How can anyone make use of a test that potentially gives an inconclusive outcome? Where does that leave the engager or the contractor?”

“If the test cannot determine definitively that you are within IR35 then the outcome ought to be outside. There can be no middle ground. If the outcome is not clearly outside, then it’s only fair on the taxpayer that the outcome is outside with a recommendation to get a formal review. Equally, if the outcome is inside, it should tell you why.”

Finally Strike emphasises: “The lack of any meaningful appeals process must fairly mean that the test errs on the side of caution, otherwise contractors are penalised unfairly.”

Piper adds that the absence of several key tests of employment renders any outcome other than a pass easily contestable: “If the tool says you are caught, it’s hard to see how you could give any legal weight to it. So it’s only useful in one direction. I would advise contractors who have failed HMRC’s tool to double check their status with another compliance solution.”

Valentine agrees that contractors shouldn’t rely on the tool, and points towards the fact that it doesn’t provide a weighted assessment of the working practices as required in the [landmark Autoclenz case](#) as evidence supporting this.

## Contractors need more clarity over questions

Questions aren’t only unperceptive and vague, they can also be misleading. When assessing control, HMRC’s tool asks whether the client can move the worker onto a different task, adding: ‘this includes moving project or location, or changing to another task within the same location’.

Contractors can afford a degree of flexibility with regards to being moved around between tasks on a project, but accepting a move to another project altogether would be an instant IR35 fail. For Strike, this poses a significant risk to contractors:

“There are many examples where the questions and answer options can be interpreted in various ways. This places those completing the test at risk of misunderstanding what is asked or answered, potentially leading to the possibility of a false outcome. For example, my opinion of what constitutes a material ‘task’ and / or ‘project’ may significantly differ from anyone else’s, yet my answer could be material in formulating the outcome.”

“This is just one of several instances of ambiguity throughout the test, each of which pose a potential slip-up for contractors,” adds Piper. “The difficulty is that the test is trying to cover an almost infinitely variable range of potential arrangements across a number of inter-related aspects of the contracts between the parties.”

## The final verdict

Subjective, vague and open to misinterpretation, our experts agree that the tool falls a long way short of what is required from a reliable IR35 assessment tool.

HMRC’s decision to instantly pass contractors with a right of substitution wasn’t roundly condemned. However, it does offer a simplified view of employment case law which risks encouraging the reintroduction of sham contracts, potentially placing contractors at risk.

Similarly, the fact that the tool has no legal backing means a pass result is of no defence in the event of an HMRC inquiry, and fails to demonstrate that reasonable steps have been taken to determine one’s IR35 status.

This is in large part down to the tool’s failure to address key areas of case law such as MOO, which means it struggles to provide an accurate indication of IR35 status in all but the obvious cases. Contractors should take receiving a ‘fail’ with a pinch of salt, and seek contract reviews or alternate, more reputable compliance solutions.

Published: Monday, June 5, 2017

© 2017 All rights reserved. Reproduction in whole or in part without permission is prohibited. Please see our [copyright notice](#).

100,000+ monthly unique visitors

© Copyright 2017 Byte-Vision Limited UK. All rights reserved [Copyright notice](#)

