HMRCs IR35 CEST tool without MOO can never be fully accurate says legal tax expert

Without considering mutuality of obligation (MOO), HMRC's Check Employment Status for Tax (CEST) tool can never claim to provide an accurate assessment of employment status or IR35, writes Matt Boddington, director at employment status specialists Chartergates.

It's well documented that CEST fails to consider MOO, one of the key tests of employment, assuming instead that it is present in every exchange of labour. This omission is a result of HMRC's inflexible stance on MOO, which is summarised in its Employment Status Manual (ESM):

'The significance of mutuality of obligation is that it determines whether there is a contract in existence at all. Without mutuality of obligation, there can be no contract of any kind.'

HMRC maintains this position, even though it is often roundly rejected by tribunals. And, though HMRC professes that CEST reflects employment case law, its omission of MOO on the grounds of an argument, which consistently fails in court, proves otherwise.

The recent cases involving Jensal Software Ltd and Armitage Technical Design Services (ATDS) Ltd both resulted in a defeat for HMRC and a comprehensive rejection of its MOO arguments; adding to a growing body of evidence that HMRC needs to reconsider its stance.

Recent IR35 tribunals expose CEST shortcomings

Tribunals throughout IR35's history have given a different characterisation to MOO, or have granted varying degrees of weight to that characterisation. However, the consistent theme from cases won by the taxpayer is that the tribunals commonly reject HMRC's notion of MOO in the context of IR35.

During the Jensal Software Ltd case heard in October 2017, Judge Jennifer Dean dismissed HMRC's arguments, while distinguishing between MOO and the 'irreducible minimum' present in every engagement:

"Although there is MOO, it does not, in my view, extend beyond the irreducible minimum, nor does it demonstrate that the relationship was one of a contract of employment."

HMRC posed similar arguments in the case of ATDS Ltd, contesting that MOO existed because engineering contractor, David Armitage's company, agreed to provide services to a client in exchange for payment. Judge Rupert Jones was candid in rejecting these claims, stating:

"HMRC's case is that where one party agrees to work for the other in return for payment, then this satisfies mutuality of obligation between

the two parties… The mere offer and acceptance of work does not amount to mutuality of obligation in the context of employment status."

Tribunal history makes grim reading for HMRC and CEST

These outcomes are nothing new. Tribunals have consistently corrected HMRC, yet it has persisted with its arguments for years. An early example was heard in 2007, during the First Word Software Ltd case, when Judge Dr Nuala Brice stated that a relevant factor was:

"…whether there is mutuality of obligation so that there is an obligation on the worker to work and an obligation on the other party to pay him and to continue to make work available during the time of the contract."

IT consultant, Neill Atkins, defeated HMRC in this case; a decisive factor being Judge Brice's conclusion that MOO didn't apply. This verdict was made on the basis that Atkins' client, Reuters, was not required to provide Atkins with work beyond the scope of the initial contract or pay him regardless of whether work was available.

The tribunal reached a similar conclusion in the Primary Path case in 2011, where it deemed that IT consultant Philip Winfield's arrangement with a client was more indicative of a contract for services. Key to this determination was the fact that Winfield had no contractual basis to demand other work or payment from his client if the project he was engaged on were to suffer a hiatus.

Contracting 'inherently inconsistent' with employment

Most contractors and agencies will readily recognise this feature of a contracting relationship: the parties are not bound together by any mutual obligations to offer and accept work, and a contractor faces inherent uncertainties about the availability of work which employees generally do not have to worry about.

Some tribunals have gone a step further and viewed the above position as not simply a pointer away from an employment relationship but as inherently inconsistent with one.

One example comes from the case of MBF Design Services, where the tribunal rejected HMRC's argument that there was always work available, accepting instead that contractor Mark Fitzpatrick would be sent home without pay if there was no work for him to do.

The Marlen case of 2011 drew an even clearer distinction between MOO in a common sense and MOO within IR35. The tribunal noted that JCB employees remained at work and were paid when the computers went down, whereas the contractor in that case was sent home unpaid. Also acknowledged was the fact that the parties could terminate the agency arrangements without consequence.

HMRC setting CEST up for a major fall

In all of the cases mentioned above, CEST would have assumed a sufficient degree of MOO to establish an employment contract, and, therefore, would have likely provided an incorrect outcome. This is even though more than half of the 13 IR35 cases that HMRC has lost have emphasised the importance of MOO.

When we consider that more than 750,000 taxpayers have trusted CEST since its inception, it seems likely that thousands of contractors are currently operating under an incorrect tax status.

HMRC must redress its stance by giving fair consideration to MOO and the inherent insecurity that contractors endure as a result of its absence. Until this is done, HMRC will continue to have its arguments quashed at tribunal.

Meanwhile, it will become increasingly apparent to the wider public that CEST is unreliable and biased towards employment. CEST has gotten as far as it has due to HMRC's unyielding insistence that it aligns with case law, but the body of evidence proving otherwise will soon be too great to ignore.

Matt Boddington LL.B(Hons) is a Director of employment status specialists Chartergates, and has considerable experience with IR35. He has won more contentious IR35 cases than any other advocate (5 in total) with a 100% track record, and this accounts for over half of all the IR35 successes against HMRC.

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