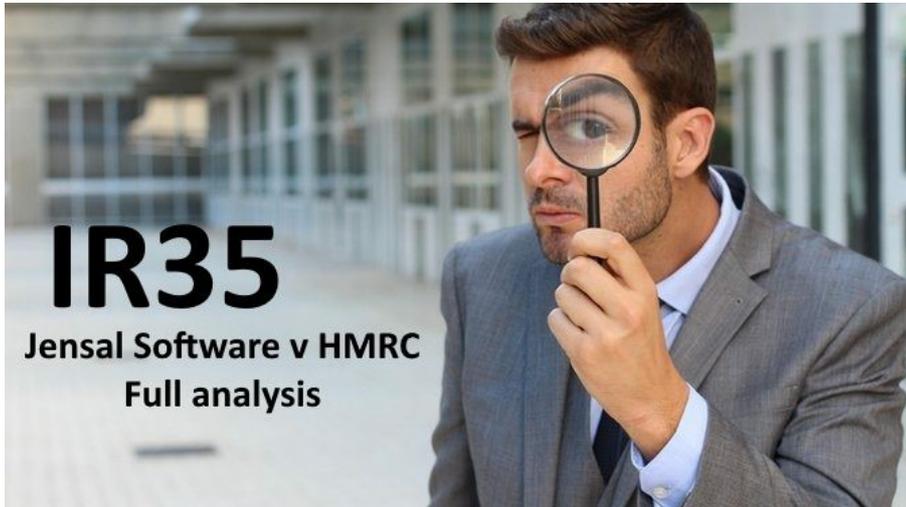


IR35 case – Jensal Software Ltd v HMRC: full analysis



The [tribunal verdict for Jensal Software Limited v HMRC](#) is another IR35 tribunal victory for a contractor has resulted in considerable embarrassment for HMRC, which, throughout the case, demonstrated its loose grasp of the legislation it is supposed to police.

IT contractor, Ian Wells, [successfully appealed a tax bill exceeding £26,000](#) relating to a succession of contracts during the 2012/13 tax year. Wells provided his services through his limited company, Jensal Software Ltd, to the Department of Work and Pensions (DWP), via recruitment agency Capita.

- All employment status indicators pointed away from a contract of employment
- Taxman's flawed interpretation of mutuality of obligation disregarded by judge
- Experts call HMRC's decision-making and integrity into question
- Poor defence proves that HMRC does not understand IR35.

"HMRC ignored more than sufficient evidence which showed the working arrangements belonged outside IR35. It's a real concern that HMRC either didn't recognise this or chose to ignore the facts before the appeal progressed to tribunal," comments [Qdos Contractor](#) head of tax Andy Vessey, who was representing the appellant.

"In my opinion, the reason the department allowed this case to go all the way was because the end client was a public sector body and they felt confident of winning; thus firing a warning shot across contractors' bows. Thankfully, it blew up in their face instead."

HMRC's control arguments 'never going to stand up in court'

HMRC relied heavily upon evidence provided by DWP officials, who noted that Wells was required to give feedback on the progress being made throughout the project. It also argued that Wells was expected to come to work each day.

However, Wells' submissions demonstrated that he had full autonomy over the work completed while noting that he would regularly work off-site under his own volition. This was confirmed by project colleague, Andrew Lemon, who noted that Wells managed his own time and location around the demands of the role.

Judge Jennifer Dean made a clear distinction between the progress updates that Wells was required to deliver and the degree of control that employees are subject to, concluding that the degree of control exercised didn't constitute a contract of employment.

“HMRC’s arguments on control hinged on the idea that progress meetings equate to supervision and direction. This was never going to stand up in court,” comments ContractorCalculator CEO Dave Chaplin. “HMRC completely misinterpreted the purpose and nature of how Wells was engaged.”

Substitution ruling could set future precedents

Much debate centred around the substitution clause in the contract between Jensal Software Ltd and Capita. HMRC pointed towards the fact that the clause wasn’t exercised and that the DWP would need to check the credentials of any substitute, as challenges towards its legitimacy.

Judge Dean acknowledged that there was some restriction on the right of substitution but was satisfied that the clause pointed away from an employment contract. Interestingly, she gave no weight to the fact that the clause wasn’t exercised, which could set precedents for future cases.

“If you read the substitution clause in the contract, it’s pretty much bulletproof, so it’s a surprise that HMRC attempted to challenge this case at all,” highlights Chaplin.

Interestingly, Wells had acknowledged that he sought a substitution clause to comply with the legislation. This admission might have indicated that the clause was a sham and HMRC duly flagged this up. However, Judge Dean stated that Wells’ reasoning for inserting a substitution clause didn’t negate the existence of the right.

Flawed MOO interpretation fails HMRC

The taxman argued that a hypothetical contract of employment existed between Wells and the DWP, based on the: ‘obligation on the DWP to provide work and for Mr Wells to perform that work in return for a consideration.

“This is an extremely narrow and flawed interpretation of the type of mutuality of obligation (MOO) required to prove an employment relationship exists,” notes Chaplin. “For IR35 to apply there has to be an obligation for the hirer to provide continued work and an obligation for the contractor to accept the work offered.

“The irreducible minimum of obligation that HMRC has flagged up exists in every contract, but it’s not enough to prove IR35 applies. Worryingly, this is the interpretation which underpins [HMRC’s decision to omit MOO from its Check Employment Status for Tax \(CEST\) tool](#).”

Martyn Valentine, director of [The Law Place](#), clarifies the correct position on MOO: “If an end-user is not obliged to provide work for the duration of the engagement there cannot be a relationship of employment.

“In the present case, the contract specifically excluded MOO and allowed for termination immediately upon notice. In other words, HMRC failed to grasp that the mutuality of obligation present in the contract did not extend beyond the irreducible minimum. This decision once more calls into question HMRC’s inability to understand MOO, and therefore IR35.”

Critically, Judge Dean rejected HMRC’s interpretation, concluding: “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.”

“This is a huge win for the contract sector,” says Chaplin. “This judgment clearly undermines HMRC’s stance and the credibility of CEST. We’ve been [waiting months for HMRC to support its assertions that all contractors are caught by MOO](#). This will make things even more interesting.”

Has the taxman been acting impartially?

The taxman’s ethics were also addressed during tribunal. Much of HMRC’s evidence relied on answers to a questionnaire which HMRC issued to the DWP in 2016. HMRC failed to seek input from Wells.

During the tribunal, Vessey noted that HMRC’s failure to approach Wells contradicted the impartiality with which it is supposed to conduct its investigations, adding: “HMRC’s job is to check if the correct amount of tax has been paid, not seek evidence to support its own case.”

Notably, this is the second time that Wells has defeated HMRC at tribunal, [with the first instance coming in 2004](#). For Qdos Contractor CEO Seb Maley, the reoccurrence raises further questions, this time over HMRC’s targeting of contractors:

“For a worker to be subject to an IR35 investigation is one thing, but twice is almost unheard of. I can’t recall another situation where a contractor has been investigated twice. You wonder whether HMRC is deliberately and wrongly targeting certain individuals.”

Does HMRC understand IR35?

The decision to take the case to tribunal was a huge misjudgement from HMRC, with every factor pointing towards a contract for services. The defence relied on weak arguments, such as the implication that Wells' daily rate was analogous to a salary, and attempts to use the upper level contract to override the working practices.

Experts are stunned that the case went to tribunal. Given the irrefutable evidence, HMRC's decision has cast serious doubts over its ability to apply and police the legislation.

"This verdict shows HMRC can't accurately assess a contractor's IR35 status," comments Maley. "The Government is serious about clamping down on what it believes to be non-compliance but, worryingly, it can't recognise whether a contractor belongs inside or outside IR35."

"This ruling is as concrete as it gets," adds Chaplin. "If HMRC can't get simple cases like this right, why should any future HMRC determination, or CEST assessment for that matter, hold any weight with contractors?"

HMRC's decision to enlist expensive legal counsel to appear in its defence has also raised eyebrows. Vessy says: "The overall cost of the case should be scrutinised. On HMRC's part, it's been a total waste of time and money - taxpayer's money."

Chaplin agrees and worries that future justice for contractors could come at a heavy price: "Aside from the fact that HMRC wasted taxpayer money on an indefensible case, this demonstrates a serious inequality of arms. How are future contractors supposed to compete with the taxman's resources? Often the cost of hiring these people is more than the sum of tax owed."

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