

IR35: Northern Lights v HMRC (UT) – IT contractor appeal dismissed by Upper Tribunal



[2021] UKUT 0134 (TCC)

Appeal number: UT/2020/000353

UPPER TRIBUNAL
(TAX AND CHANCERY CHAMBER)

NORTHERN LIGHT SOLUTIONS LIMITED

-and-

THE COMMISSIONERS FOR HER MAJESTY'S
REVENUE AND CUSTOMS

HMRC's Upper Tribunal (Tax and Chancery Chamber) (UTT) victory over contractor Robert Lee and his company Northern Lights highlights the importance of effectively communicating working practices at an early stage. It also highlights how Tribunal Judges can draw on partial sections of case law to reach their conclusion.

According to ContractorCalculator CEO Dave Chaplin, who personally attended both days of the proceedings, there are important lessons to draw from what he considers to be a questionable decision: "It is unfortunate that in Lee's case the First-tier Tribunal (FTT) did not appreciate the realities of how major IT projects work, how much autonomy project managers enjoy and the irrelevancy of change frameworks within a working project.

"As a result of multiple factors, including how the evidence was presented by HMRC and interpreted by the tribunal, alongside some surprising remarks around the case law aspects of control and mutuality of obligation (MOO) by the judges, this ruling does appear to be somewhat unfair."

Key lessons from Northern Lights:

- HMRC's evidence from the notes of meetings, which underpinned several aspects of the ruling, appears to frame the facts relating to substitution and control in a manner which does not align with what really happens on the ground in IT projects, highlighting the importance of keeping a more robust and evidenced audit trail on projects in the new era of Off-payroll.
- In Chaplin's view, the facts and realities of the working practices on IT projects and what they mean were not fully appreciated at FTT. It is important to have a pre-emptive defensible position prepared, in the event HMRC presents a version of events that does not match the reality and actual facts.
- The facts around the 'how' aspect of control, in Chaplin's experience of running IT projects, was unlikely to reflect the actual working arrangements. 'Change frameworks' are a red herring and alongside reporting is not evidence of heavy control
- A genuine expressed right of substitution, if not exercised and not backed up by the client, is still unsurprisingly not an IR35 defence. The judges relied on Lord Wilson's dominant purpose test from Pimlico Plumbers.

Unexercised substitution clauses still window dressing

Lee's contract did include a legitimate unfettered right of substitution, but it was never exercised, and the client never gave witness evidence

to back it up as a genuine right. As a result, the judges chose to disregard the substitution clauses, relying instead on Lord Wilson's dominant purpose test in *Pimlico Plumbers*. Chaplin notes: "Judges commonly see right through these types of clauses with little or no bearing on the reality of the intended engagement that have been inserted into contracts. This is not new."

"As far back as 2008 in the *Alternative Book Company* case the phrase 'window dressing' was coined to describe such clauses. Substitution is no silver bullet to definitively prove a worker is not employed unless it has genuinely taken place. On the run up to the private sector Off-payroll reforms, we've seen all sorts of weird and wonderful misguided models emerge that are designed to game the case law solely around substitution and have consistently warned against them."

HMRC argued that the client, Nationwide Building Society (NBS), required Lee specifically because of his knowledge of internal processes, so his personal service was required. The reality is that this simply made Lee's company a strong candidate for the contract, because if he'd not been available, NBS would have found another solution.

"Whilst I have misgivings about some of the conclusions drawn from the fact-finding on this matter, having reached the factual conclusions they did, the law appears to be correctly applied," highlights Chaplin. "However, many businesses are one-man bands and deliver the services personally. But that alone certainly does not mean they are all employees. The more important area, where these cases are played out, is control."

Is this a worrying precedent over evidence of control?

Chaplin's concern following this case is that the existence of an operating framework within a client's organisation that contactors must follow is sufficient to prove control over how the work is completed. Furthermore, the judges dismissed Lee's contractual right to refuse redeployment onto an alternative project – he was clearly no 'tail-end Charlie' with no control over what he did.

"Having over two decades of experience in IT, with many years spent in large blue-chip organisations, and as other IT professionals will tell you, these procedures would have largely been paid lip service to, as are most methodologies. Teams tend to pick and choose from various methods and design a process applicable for the project they are working on. Sure, there might be some loose framework to consider, but this is hardly a master-servant level of control that the ruling appears to indicate."

NBS was also unable to redeploy or reassign Lee to other areas of the business as it chose without his agreement, and he could refuse. This shows a clear lack of control over the 'what' element of Lee's engagement and the 'what' element is often considered the most important and weighty aspect when determining employment status. Yet, the judges did not consider this lack of control to be significant.

Chaplin urges caution when interpreting this UTT judgement, because it is the role of the FTT to consider and weigh the facts accordingly. The ruling noted that it is not the UTT's role to override any decision about what facts should apply.

The usual confusion, and contention, over mutuality of obligation

Historically in IR35 cases, the importance of mutuality of obligation (MOO) falls in and out of fashion. HMRC decides on its importance according to expediency and appears to believe any role where a worker is paid to do something confirms that MOO exists and that means they are employed. The reality, believes Chaplin, is more complex, as cases such as [RALC Consulting](#) demonstrate:

"Paragraphs 91, 93 and 94 of the *Northern Lights* UTT ruling show how the judges oscillate over their position on MOO. They claim that being engaged to perform a specific task is not inconsistent with employment, nor is the early termination of the contract, falling back on payment for work done as the minimum test.

"In paragraph 97, Lee's counsel proposed an argument that MOO could not be present because Lee could refuse work. I would agree: how can there be mutual obligations in a work/wage bargain sense if the worker can simply refuse? The whole point of employment is that the employee agrees to guarantee to make themselves available for a minimum amount of time, and the employer agrees to give them work, and pay for their time whether work is offered or not. That does not exist when it is only payment for work done.

"In paragraph 98, it is claimed that the argument about work cutting short is about control, but then they claim there is sufficient control. The arguments appear muddled. It is disappointing for the judges to reject this notion. This concept will be reexamined in the [Professional Game Match Officials](#) (PGMOL) case that is going to the Court of Appeal."

The key point in my view is whether there is an ongoing requirement to offer and accept work. In Lee's contract and the actual relationship he had with NBS this is not the case, but that argument does not appear to have been explored in depth.

Informing IR35 Off-payroll best practice

"When Off-payroll came into force, everything changed but nothing changed," notes Chaplin. "As has been the case for over twenty years, it is evidence, evidence and more evidence that's needed to mount a solid defence. It is also essential to secure sign-off from all stakeholders, including clients, on what the actual facts were during a contract, not a subjective interpretation."

HMRC frequently produces evidence and notes of meetings that appear to suffer from unconscious bias, and that often overlook material facts because they do not support the taxman's narrative. Not mentioned in the UTT ruling were some of the facts that the FTT relied upon, particularly in relation to HMRC's notes of meetings.

Lee, his adviser and HMRC held a meeting, but the former were not allowed to speak. Following the meeting, HMRC wrote-up the notes but omitted the questions asked to obtain the information. Lee disputed many 'facts' reported in the notes, but in the absence of any other evidence, this is all the judges had to work on.

"In RALC Consulting, the judge saw through HMRC's notes of meetings, highlighting key evidence in notes of meetings having been "filtered through the medium of an HMRC note taker," adds Chaplin. "Northern Lights' case report shows how, despite the contractor and his professional advisers' best efforts, the judge can choose HMRC's narrative to drive the decision."

Did the judges err in law?

Northern Lights is also an example of the continuum that exists over the reality of contracts, with total acceptance at one end and total rejection at the other. As highlighted above, the UTT considered the unexercised substitution clause in Lee's contract as not relevant, using [Atholl House](#) as the precedent in paragraph 12 to consider "the circumstances".

However, questions remain over whether this should have been interpreted to mean a complete disregard for entire parts of the contract and its terms, which appears to have happened with the substitution clause. The judges quoted one element of the key paragraph [8(1)] in the Atholl House ruling, but the ruling, another that Chaplin personally attended, was not in his view intended to give licence for contracts to be entirely disregarded.

"There was considerable discussion around this point, which was not included in the decision, about how much 'violence' could be done to the contractual terms during the importation into the hypothetical contract, and the theme certainly wasn't to give a right to completely disregard terms."

8(2) of Atholl House backs this up: "care must still be taken to ensure that ordinary principles of contractual interpretation are correctly applied" and "if the terms of actual contracts are wrongly construed, any error has the potential to infect the ascertainment of the terms of the hypothetical contract". Chaplin believes that the judges may have erred in law on this point, but that is not to say that any challenge to the Court of Appeal would necessarily overturn the decision.

What does Northern Lights mean for future IR35 and Off-payroll cases?

Lee worked on multiple contracts and projects with NBS on and off for seven years. The length of the relationship should not be a factor in the decision. Duration is not a case law factor itself, but longevity can result in other stronger pointers of employment crystalise.

Unexercised substitution clauses when there is no real intent or ability to substitute are still mere window dressing, despite any claims to the contrary – and unless both sides robustly defend them as valid, they will fail to convince a judge.

Chaplin concludes: "Will this case be appealed? There may well be grounds for it, but perhaps not the appetite on the part of the contractor. The entire case cannot be argued again, and the factual conclusions drawn at FTT based on the evidence cannot be re-examined.

"There might be scope on the matter of control and mutuality of obligation, depending on the result of the PGMOL Court of Appeal ruling, so it might be worth making a preliminary application based on that, if the appetite and funding is available."

Published: 11 June 2021

© 2021 All rights reserved. Reproduction in whole or in part without permission is prohibited. Please see our [copyright notice](#).

200,000+ monthly unique visitors

© Copyright 2021 Byte-Vision Limited UK. All rights reserved [Copyright notice](#)