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PGMOL Court of Appeal ruling means CEST overhaul now required

The Court of Appeal decision in HMRC v Professional Game Match Officials Limited (PGMOL) has reaffirmed again that the taxman's interpretation of mutuality of obligation (MOO) is wrong in law, leaving HMRC no option but to send its flawed Check Employment Status for Tax (CEST) tool back to the workshop.

And despite the case heading back to the First-tier Tribunal for the final evaluation of the facts and decision, the important principles laid down by the Court of Appeal are now binding in law, rendering the taxman's position on mutuality of obligation untenable. The decision also reinforced the importance of considering all elements of status "in the round", contrary to how CEST also makes many of it's status decisions.

"All the critics have been proved right on this matter, " says Dave Chaplin, CEO of IR35 Shield, "and we now have binding law from the Court of Appeal on the matter, which HMRC must now follow. In the meantime, until CEST is fixed, it's difficult to see how anyone using it who is aware of it's flaws can claim they are adhering to the legislative requirement to take reasonable care in coming to the conclusion in their determinations."

What are the key legal principles from the PGMOL Court of Appeal ruling?

The ruling fully addressed mutuality of obligation (MOO) across the areas of overarching and single engagements, whether a contract exists, if it is one of employment, and whether it can solely lead to concluding a contract is not one of employment. The principles, laid down in paragraphs 118 to 133, are:

> 1. The question whether a single engagement gives rise to a contract of employment *is not resolved* by a decision that the overarching contract does not give rise to a contract of employment. (Paragraph 118).
> 2. [if] there is no obligation under the overarching contract to offer, or to do, work (if offered) (or that there are clauses expressly negativing such obligations) *does not decide* that the single engagement cannot be a contract of employment. The nature of each contract is a distinct question. (Paragraph 118)
> 3. A single engagement *can* give rise to a contract of employment if work which has in fact been offered is in fact done for payment (Paragraph 118) [Emphasis added]
> 4. The court has to look at all the circumstances in the round before deciding whether or not there is a contract of employment (Paragraph 119)
> 5. The fact that both sides can withdraw before performance of the contract does not negate the existence of a contract. (Paragraph 125)

> 6. To establish whether individual contracts are contracts of employment one needs to consider both ***sufficient*** mutuality of obligation and control. (Paragraph 133)

Chaplin says that the ruling has clarified many of the longstanding debates on mutuality of obligation: “Each engagement itself must be looked at, it cannot be used as a trump card to conclude an engagement is outside IR35, and aspects of MOO need to be considered in the round alongside all the other factors when making a final determination.

“HMRC attempted to defend their longstanding position that MOO was only relevant to the question of whether there was a contract at all, and this proposition has now been entirely rejected. The nature of the obligations, and sufficiency of MOO must be considered in the round, with all other factors.”

What did the Court of Appeal in PGMOL say about Mutuality of Obligation?

Martyn Valentine of The Law Place explains: "The PGMOL judgment reaffirms the Court of Appeal's previous interpretation of mutuality of obligations in *Prater*. Indeed, Laing LJ quoted Mummery LJ: "The mutuality created by Mrs Prater being contractually obliged to work during each successive engagement was not …the same mutuality necessary to constitute the "irreducible minimum" required for a contract of service to exist. Simply working hard on a regular basis under a series of short engagements one after another was not enough to make Mrs Prater an employee of the council. There had to be a continuing obligation to guarantee and provide more work and an obligation on the workers to do that work" (paragraph 66).

Valentine explains the impact in an IR35 context: “Mutuality of obligations can be imputed by reference to the description of the services. By the same logic used by Mummery LJ in *Prater*, if the substance of the engagement is for the individual contractor to undertake the role of a "project manager" (in a similar manner to *Northern Light Solutions Limited*), there is an obligation upon the client to provide work within that skill set and for the contractor to undertake the work. When a client clearly wants an individual to undertake a role this fatally weakens the influence of a contractual substitution clause.”

“The PGMOL judgment is relevant for the question of whether a single engagement gives rise to a contract of employment (or deemed employment for tax purposes) and is therefore applicable in an IR35 context, “ explains Valentine. The four binding judgments, *McMeechan*, *Clark*, *Carmichael* and *Prater* require the court to "look at all the circumstances in the round before deciding whether or not there is a contract of employment" (paragraph 119) which broadly reflects the statutory requirement to consider the "circumstances" of an engagement including the terms on which the services are provided.“

Martyn says that “It seems difficult to escape the conclusion that HMRC has now inadvertently mislead taxpayers by continually insisting that mutuality of obligation is established in an employment context simply by the obligation for the contractor to work and for the client to pay the contractor for the work.”

How will the PGMOL Court of Appeal ruling impact IR35 assessments?

Firms who have been using CEST or putting too much reliance on mutuality of obligation and using it as a trump card to conclude “outside IR35” may need to revisit their historic assessments and regear their assessment processes going forward.

The Court of Appeal also confirmed the longstanding case law, laid down in the Hall v Lorimer case, that all the factors need to be considered in painting the picture and then a “standing back” evaluation should be taken.

Chaplin says that “If firms are relying on isolated areas in law to make determinations rather than considering all factors in a balancing exercise, then those firms will need to revisit those processes and check previous assessments if they have been relying too heavily on mutuality of obligation as a get-out-of-jail card.”

What specifically needs to now be fixed with CEST due to PGMOL?

CEST needs to go back to the workshop, because it now contains two fundamental flaws which are misaligned with the binding case law from the Court of Appeal ruling.

CEST now has the following two areas of exposure:

> - If an “outside IR35” determination is given due to a valid right of substitution, or meeting the conditions in the control section, then those tests may cause a problem, because the underlying algorithm has not considered other areas in the round, and instead handed out a trump card. This fact can be confirmed by examining the underlying CEST algorithm which is in the public domain and published online.

> - None of the determinations have considered mutuality of obligation at all, because HMRC purposefully omitted it from the tool based on their longstanding policy view of mutuality of obligation.

The designers of CEST will need to include questions about the nature of the mutual obligations, and make sure that all determinations are doing by considering all factors in the round, especially when handing out determinations that are “outside IR35”.

Does using CEST no longer meet the requirements for reasonable care?

Chaplin warns that it is highly likely that firms may now face challenges that they have not adhered to reasonable care in coming to their determinations if CEST has been used.

Reasonable care is a complex topic especially in the context of Off-payroll – because there is often accidental conflation with the reasonable care requirement in Section 61NA(2) in Chapter 10 ITEPA, and reasonable care in the carelessness sense from the Taxes Management Act 1970.

Chaplin says: “Whether reasonable care has been taken requires first assessing what was in the mind of the person at the time the act was taken. It’s theoretically possible that someone conducting assessments has never comes across Google and read about these issues, but convincing a First-tier judge might be a challenge.

“It's difficult to see how anyone using the now outdated CEST can claim they are adhering to reasonable care in coming to the conclusion in their determinations, which creates many issues.”

Valentine clarifies that as a matter of law the standard for assessing whether reasonable care has been taken "is that of a prudent and reasonable taxpayer in the position of the taxpayer in question" per Judge Berner in *HMRC v Collis* [2011] TC 01431. Relying on the discredited CEST tool cannot be taking reasonable care, and isn’t what a 'prudent and reasonable taxpayer' would do – certainly not until it is fixed.

If reasonable care is not taken, warns Chaplin, then a considerable mess is created: “If the conclusion in the Status Determination Statement (SDS) was reached without taking reasonable care, then the SDS is invalid. One consequence of that is that the client remains the fee-payer, not the recruitment agency, and the client must make the tax deductions, and the agency has no lawful right to and must make payments gross.

“It is in everyone’s best interests to make sure reasonable care is met, and that all parties are bought into the method and credibility of the assessments being conducted.”

Why did the PGMOL decision get sent back to the FTT?

Whilst the Court of Appeal resolved many of the longstanding legal debates around mutuality of obligation, they did not reach a conclusion on the actual case itself, and instead remitted this back to the First-tier tribunal.

In paragraph 133, Laing LJ said: “…the appeal should be remitted to the FTT for the FTT to consider, on the basis of its original findings of fact, whether there were sufficient mutuality of obligation and control in the individual contracts for those contracts to be contracts of employment. I do not consider that it would be appropriate for this Court to make those assessments, which are assessments best made by a specialist fact-finding tribunal, not an appellate Court.”

Chaplin explains: “It is for the First-tier Tribunal to make decisions about credibility of evidence, weight of evidence, and how those are to be balanced, not the higher ones. And because there are questions about weight and relevance of evidence, these are not matters which the Court of Appeal has authority to deal with. The parties have been invited to make submissions about disposal, and at this stage we don’t know whether the case will simply be revaluated based on the existing evidence without another hearing, or whether a partial or full rehearing will take place.

“But, whilst the parties are yet to learn of their final fate in this case, the Court of Appeal has set legal precedent and resolved the issues around mutuality of obligation which cannot be ignored.”

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