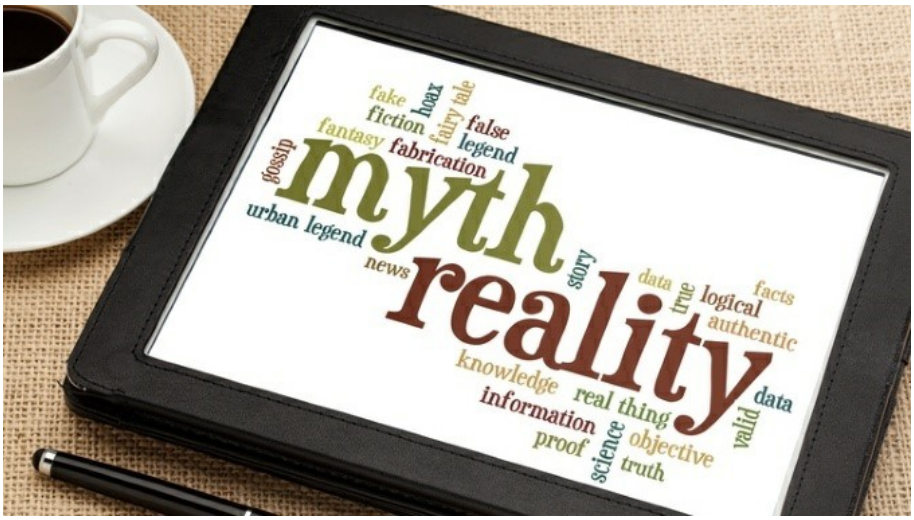
Rough Tax Justice II – IR35 defence duo pinpoint importance of fact-find



The IR35 defence duo Chris Leslie of Tax Networks and Dave Chaplin of IR35 Shield explore issues at the coalface of their IR35 defence work.

Keen IR35 readers will recall we co-wrote "Rough Tax Justice" in December 2019 about a dissection and repair in RALC Consulting Ltd v HMRC by the fact-finding First-tier Tax Tribunal ("FTT"). On this specialist topic we return to the RALC case, comment on a parallel with the more recent judgement in Northern Light Solutions Ltd by the Upper-tier Tax Tribunal ("UTT") and draw upon our insights gained at the coal face of our IR35 defence work to provide some comfort for firms entering the new world of the Off-Payroll Legislation.

HMRC v RALC Consulting – case still in surgery

To refresh our memories, RALC provided niche skills and operated its business through several contracts in the IT Industry. HMRC's opinion was that RALC was caught by IR35, and they attended the FTT with an army comprising of two barristers, lawyers from HMRC Solicitor's Office and HMRC Officers. The appeal hearing took several days and included a detailed cross-examination of the Appellant's witnesses and its Director Mr Alcock who was subjected to eight hours of interrogation by HMRC's lead-counsel. A plethora of evidence was deduced alongside the relevant case law, and yet HMRC considered that the FTT's Decision was perverse. Consequently, HMRC applied for leave to appeal the decision in the UTT, apparently pleading errors in law which HMRC allege were made by the judge and member at FTT. We respectfully disagree.

Where HMRC challenges are on the fact-find conducted by the FTT, it is ironic when you consider HMRC's IR35 Opinion Letter was predicated from typed-up notes which the Judge's Decision says was based on "hearsay and filtered through the medium of an HMRC note taker." A double whammy perhaps when considering HMRC's same lead-counsel reminded the judges in the recent Northern Light Solutions case that the UTT should be reluctant to interfere with the evaluative judgment of the FTT unless it has misdirected itself as to the law, misapplied the law to the facts, or has reached a conclusion which is not open to it on the facts found, all in accordance with the well-known principles set out in Edwards v Bairstow.

HMRC v RALC at the UTT was initially going to be heard in July 2021, but the parties have agreed to stay the case behind two cases heading to the Court of Appeal - HMRC v PGMOL (July 2021) and HMRC v Atholl House Productions (expected early 2022) – two other cases that also didn't suit HMRC's IR35 interpretation. If RALC then goes ahead, we may not discover the outcome until after Summer 2022, a full eight years since HMRC first opened its IR35 review.

Justice delayed is justice denied and at great expense to the public purse. For Mr Alcock, rough tax justice continues.

Northern Light Solutions v HMRC

To reinforce the reasoning for RALC's success in the FTT, there was contextual evidenced-based submissions made on behalf of the

Appellant to counter HMRC's literal interpretation on the contracts. Unfortunately, it appears the same cannot be said in the Northern Light Solutions case, which recently had its appeal dismissed by the UTT in the judgment released on 8 June 2021, highlighting the crucial importance of the forensic fact-finding needed leading up to the initial FTT and the necessity of overcoming any potential inaccuracies contained in, for instance, typed-up notes by HMRC following meetings with other parties.

In our opinion, HMRC may have got away with it in the FTT, based on the facts it collated for the case. Despite putting forward their Notes of Meeting as evidence, similar in RALC, HMRC provided no cogent witness evidence and an Officer was not cross-examined under oath on these notes (see paragraphs [15], [16] and [17]). Also significant, is the Footnote on page 5 of the Decision, informing us that the end client, "NBS and its employees, as we have noted, did not give evidence and we assume that the FTT meant that, in this respect, it accepted the contents of the Notes."

The presence of HMRC Notes of Meetings but without the presence of witnesses who contributed to them to undergo cross-examination, is a common hurdle, and one the Appellant can struggle to overcome, unless their client is amenable to providing evidence.

HMRC clearly held the pen, and their Notes were unchallenged under critical cross-examination by the Appellant in the earlier fact-finding FTT proceedings, primarily because those witnesses apparently refused to attend court, nor were they summoned. Was this another incidence of rough tax justice?

Do the Parties need witnesses?

The current tribunal system primarily deals with binary disputes between a taxpayer and HMRC, but is presented with a different challenge in IR35 cases, because there are three parties, where the taxpayer, HMRC and the end client all have their own interests to protect.

HMRC have the power to serve notices of PAYE determinations and NIC decisions and form an IR35 Opinion based on the evidence they collate, and they are not legally obligated, nor do they typically choose, to invite or summon witnesses to be cross-examined if matters proceed to the tribunal. This presents a considerable challenge to counter HMRC's interpretation of the facts which are often based on typed-up notes of a meeting prepared through the filter of an HMRC Officer and imported into their Opinion Letter.

With the burden of proof on the Appellants, they face the difficulty of convincing their end clients to assist with evidence, and ideally providing a witness statement followed by attendance at the tribunal. When Witness Statements are obtained from the end client and the Personal Services Company Director, these must contain credible witness evidence, because it will undergo rigorous cross-examination by HMRC's barrister.

But, if the end client is unhelpful or refuses to attend, this can run the risk of the Appellant being left to hang out to dry.

The lack of witnesses also present difficulties for the judges in IR35 cases, who have expressed disappointment at key witnesses not being made available (e.g. see Atholl House Productions FTT, Paragraph 83), leaving them to make decisions on evidence which may not have borne scrutiny if subjected to cross-examination.

One option is for the Appellant to consider summoning witnesses under the criteria found in Rule 16, if they have declined to attend voluntarily. But, because the relevant tax period is likely to be many years before the enquiry started, the key personnel may have since departed and cannot be located. Witnesses are also unlikely to have experience in tribunal proceedings compared to HMRC's highly skilled barristers who cross-examine them. With memory fading faster than ink, how reliable is someone going to be who has been summoned against their will?

Witness evidence is crucial in IR35 cases, and the primary reason why IR35 appeals are not straightforward and require a safe pair of hands to avert rough tax justice.

The need for a pre-emptive tax defence

There are many fundamental differences between the original IR35 Legislation (Chapter 8 of ITEPA) and the new Off-Payroll legislation (Chapter 10 ITEPA), and from a tax defence perspective the difference is now considerable.

In the 'old world' of Chapter 8 we had to retrospectively consider IR35 status after the contract commenced, following which all the events had taken place and facts were known. But in the 'new world' of Chapter 10, we need to ascertain many of the facts upfront, before the contract is executed, and if we decide it's not deemed employment, then we need to (a) make sure it stays that way, (b) find out if it changes during the contract, and fundamentally (c) we need to gather contemporaneous evidence during the contract, to shore up the original determination which was largely based on assumptions.

Essentially, we are entering a new compliance era, that of needing to implement an ongoing pre-emptive tax defence strategy. And, as we have seen, for tax tribunals, you will need these corroborated evidence-based facts to discharge your burden of proof.

But, this is where there can be a silver lining to the new Off-payroll legislation.

The past does not equal the future

In this new era of Chapter 10, clients must make the assessments, they have skin in the game, and they are usually well represented. It's highly unlikely, once they adopt a good process that meets the requirements for reasonable care, that HMRC will be able to overcome the decisions at tribunal, simply because they aren't going to go AWOL and sack their own cases, allowing "alternative facts" to be found by eager pen-holding inspectors. And with contractors now being asked to sign contractual indemnities if they are hired "outside IR35" they also have considerable skin in the game. Neither are likely to hang the other out to dry.

So, as you head into the new world of chapter 10, build your tax defences pre-emptively, using strong factual foundations and this will help you ensure you don't become a future victim of rough tax justice.

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