

## Under the bonnet of the HMRC IR35 tool



HMRC's IR35 tool is shallow, doesn't align with how tribunal cases are judged, contains flawed logic, and cannot provide contractors with an accurate IR35 judgment.

ContractorCalculator acquired a copy of the underlying design documents of the tool, and conducted a detailed examination to determine exactly how it was built and works. Key findings were:

- Key areas of employment case law are ignored
- Questions irrelevant to case law are included
- The accepted legal method of using a stand-back approach to consider the big picture isn't applied
- The pass bar is too high – too many outside-IR35 contractors will fail

"The shortcomings of the tool's design are disappointing but perhaps not surprising considering the short time HMRC left itself to build it, together with its distorted interpretation of employment case law," says ContractorCalculator CEO Dave Chaplin.

"From looking at the tool's blueprint, it's now clear why it hasn't been producing accurate results. Contractors need to be aware that failing HMRC's tool doesn't mean they are caught by IR35."

### How should employment status be determined?

In the landmark case of [Hall v Lorimer \(1993\)](#), Lord Justice Nolan stated:

*"In order to decide whether a person carries on business on his own account it is necessary to consider many different aspects of that person's work activity. This is not a mechanical exercise of running through items on a check list to see whether they are present in, or absent from, a given situation. The object of the exercise is to paint a picture from the accumulation of detail.*

*"The overall effect can only be appreciated by standing back from the detailed picture which has been painted, by viewing it from a distance and by making an informed, considered, qualitative appreciation of the whole. It is a matter of evaluation of the overall effect of the detail, which is not necessarily the same as the sum total of the individual details. Not all details are of equal weight or importance in any given situation. The details may also vary in importance from one situation to another."*

The process detailed in this landmark case is how all employment status cases have been judged for over two decades.

One has to consider ALL of the details using a stand-back approach to examine the big picture. When considering if someone is outside IR35, HMRC's IR35 tool does not follow the direction by Justice Nolan - instead it uses a separated approach.

## How does HMRC's IR35 tool work?

HMRC's IR35 tool asks questions across four sections:

1. Personal service / substitution
2. Control
3. Financial risk
4. Part and Parcel

The tool has adopted a 'golden pass ticket' approach, whereby providing certain answers to specific questions in either of the first three sections can mean a contractor achieves an immediate 'outside IR35' result without having to answer any further questions.

This is contrary to how judges examine employment status cases.

## How does HMRC's tool contradict case law?

HMRC's approach of handing out a 'golden pass ticket' means in many instances crucial factors impacting IR35 status will be completely bypassed by the tool. As a result, the whole picture cannot be painted and therefore considered using a stand-back approach, which is the only way to accurately evaluate employment status.

"HMRC has adopted a very crude approach to designing its test," comments Chaplin. "The test essentially begins by assuming every user is inside IR35 by default. Then it attempts to identify any strong passes.

"A small fraction of contractors who the tool can't identify as strong passes may be moved from a default fail to 'unable to determine', but that's no use to anyone. The logic for handing out passes is fundamentally flawed. HMRC needs to throw it away and start again."

## What key IR35 factor does HMRC fail to address?

HMRC has even chosen to disregard one of the fundamental employment status factors; 'mutuality of obligation', or 'MOO'. In case law, once personal service is established, control and MOO are considered the two irreducible minimums that must be present to assert an employment relationship exists. The absence of checking MOO is a glaring omission which calls into question the entire credibility of HMRC's tool.

"It's quite astounding that their tool completely ignores MOO," adds Chaplin. "It's like asking a contractor to take their driving test, but only checking whether they can drive down straight roads."

## HMRC places too much emphasis on substitution

HMRC curiously provides an instant pass to contractors who claim they have an unfettered right of substitution, without examining any other factors. No tribunal judge has ever made a decision based on substitution alone, and by issuing automatic passes based on a claimed right to substitution, the taxman is acting contrary to case law, as Chaplin highlights:

"In the past judges have overruled substitution clauses, considering them tantamount to window dressing, often for good reason. The only 'silver bullet' is if an actual genuine substitution has taken place – and few contractors will be able to claim that.

"[The landmark Autoclenz case](#) in employment law set a precedent whereby judges can entirely disregard contracts, instead looking solely at the facts on the ground. This could very easily contradict any claimed right to substitution, moving the onus to control and MOO.

"This current feature of the HMRC tool invites misuse and misleads contractors into a false sense of security. Given that many contractors are hired as individual experts and do not substitute means many won't pass the tool this easily, but also doesn't mean that they will fail IR35."

## IR35 tool 'not sophisticated enough' to accurately determine control

Another serious flaw is the massive oversimplification when assessing the 'control' component of a working relationship. Chaplin uses an example to illustrate the tool's shortcomings:

“The tool asks whether the client has the right to decide how the work is done once the worker has begun the engagement. One of the options provided is ‘partly’. This is the likely choice for most contractors who, whilst not told exactly how to do their work, will allow for a degree of flexibility when discussing how to achieve deliverables. But to achieve a pass from the tool here, contractors need to answer no. In real life, working relationships aren’t that clear cut.

“A man came round to fit air conditioning the other day. We discussed how he was going to carry out the work, where the fans would be located and how he would trunk all the pipes, but that didn’t make him our employee. HMRC’s tool isn’t sophisticated enough to realise this.”

There is even more confusion to navigate. Where the tool asks whether the client is able to move the worker between tasks, its phrasing uses both the terms ‘task’ and ‘project’, posing a potential pitfall for contractors:

“It comes down to the contractor’s interpretation of what is meant by a poorly phrased and unclear question,” says Chaplin. “Moving people between tasks on a project is fine for IR35 purposes. It’s when you move them onto another project altogether that the contractor becomes caught by IR35. A contractor could easily misinterpret this question, costing themselves a pass in the process.”

### **Can a contractor pass the IR35 tool based on financial risk?**

Financial risk provides the contractor’s last chance to pass IR35 with the tool. This is a secondary factor when considering IR35. However, contrary to law, HMRC has decided that there are some elements of financial risk that will override all the main factors entirely.

From examining the underlying design, it’s clear that getting a pass for financial risk is hard for a knowledge-based contractor. Assuming a contractor is on an hourly or daily rate, to then get a golden pass ticket in this section they will need to confirm that they spend money on travel and incur significant expenses amending errors in their work. For Chaplin, this flags up another of the tool’s shortcomings:

“A construction contractor may incur costs for materials through their company but that doesn’t apply to many other sectors. Take an IT contractor. Any so-called ‘errors’ are fixed as they go along, fine-tuning until the product is ready. They don’t spend money putting things right, rather they might offer some extra time for free.”

### **HMRC demonstrating ‘the barest understanding of the law’**

HMRC’s tool ends with a section on ‘part and parcel’, a secondary factor when considering IR35. This is ironic because in law part and parcel is considered more important than financial risk and there is no way for a contractor to get a golden pass ticket by answering questions in this section. From here on in, users are doomed to receive either a fail or an inconclusive judgment.

“The fact that ‘part and parcel’ doesn’t hold enough sway to grant the user an automatic pass is proportionate with its importance. It’s an area where its presence can negatively affect your status, but makes little difference if it isn’t. Either way, for the tool it makes no real difference, because once you have got this far you cannot achieve a pass.

“It’s just another peculiarity of a tool that has areas missing, questionable weightings, and only a basic understanding of the law it is designed to uphold,” concludes Chaplin.

“Perhaps the fact that the tool doesn’t align with the law doesn’t matter much to the taxman, because as we have seen the mere threat of tax liability falling on the agencies and clients has forced many genuine contractors into false employment – so HMRC has its money anyway.”

**Expert Contributor**



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