NATIONAL INSURANCE CONTRIBUTIONS - services provided through service company - if the arrangements had taken the form of a contract between the Appellant and the client whether the Appellant would be regarded as employed - yes - appeal dismissed - Social Security Contributions and Benefits Act 1992 Ss 2 and 4A; Social Security Contributions (Intermediaries) Regulations 2000 SI 2000 No. 727 Reg 6(1)

THE SPECIAL COMMISSIONERS SpC 00287

EDDIE BATTERSBY

Appellant: use right arrow to move to starting point after this box Appellant

- and -

STEPHEN DAVID CAMPBELL

(HM INSPECTOR OF TAXES)

Respondent

Respondent

SPECIAL COMMISSIONER : DR NUALA BRICE

Chairman's name: use right arrow to move to starting point after this box

Sitting in private in London on 3 August 2001

The Appellant in person

BarryWilliams, Regional Advocacy Adviser, for the Respondent

ANONYMISED DECISION

The appeal

1. Mr Eddie Battersby (the Appellant) appeals against a decision made on 29 November 2000 relating to national insurance contributions. The decision was:

"That the circumstances of the arrangements between Mr E Battersby and Pennyright Bank for the performance of services from 31/05/2000 to 29/11/2000 are such that, had they taken the form of a contract between Mr E Battersby and Pennyright Bank, Mr E Battersby would be regarded for the purposes of Parts I to V of the Social Security (Contributions and Benefits) Act 1992 as employed in employed earner's employment by Pennyright Bank. That E.B.COM Limited is treated as liable to pay primary and secondary Class I contributions in respect of the worker's attributable earnings from this engagement."

The legislation

2. The legislation relevant to the issue in the appeal has become known colloquially as the IR35 legislation because that was the reference number of a Press Release which was issued by the Inland Revenue on 9 March 1999. The Press Release was entitled "Countering avoidance in the provision of personal services." The legislation proposed in the Press Release changes the treatment, for the purposes of income tax and national insurance contributions, of payments made to service companies. This appeal concerns only national insurance contributions.

3. The legislation about the payment of national insurance contributions is contained in The Social Security Contributions and Benefits Act 1992 (the 1992 Act) which contains separate provisions applicable to employed earners on the one hand and self-employed earners on the other. Section 75 of the Welfare Reform and Pensions Act 1999 inserted a new section 4A into the 1992 Act to take effect from 22 December 1999. New section 4A provided that Regulations might make provision for securing that, in stated circumstances, payments to service companies should be treated as earnings paid to a worker in respect of an employment. The Regulations made under the provisions of new section 4A are the Social Security Contributions (Intermediaries) Regulations 2000 SI 2000 No. 727 (the 2000 Regulations). These came into force on 6 April 2000. The relevant part of Regulation 6 provides:

"6(1) These Regulations apply where-

(a) an individual ("the worker") personally performs, or is under an obligation personally to perform, services for the purposes of a business carried on by another person ("the client"),

(b) the performance of those services by the worker is carried out, not under a contract directly between the client and the worker, but under arrangements involving an intermediary, and

(c) the circumstances are such that, had the arrangements taken the form of a contract between the worker and the client, the worker would

be regarded for the purposes of Parts I to V of the Contributions and Benefits Act as employed in employed earner's employment by the client."

The issue

4. The Appellant is a computer consultant. In 1988 he established a limited company through which he supplied his services (the service company). In 1993 he started supplying services to Pennyright Bank through the service company. It was not disputed that the Appellant personally performed services for the purposes of the business carried on by Pennyright Bank and that the performance of those services was carried out not under a contract directly between the Appellant and Pennyright Bank but under arrangements involving an intermediary (namely the service company) within the meaning of sub-paragraphs (a) and (b) of Regulation 6(1).

5. Thus the issue for determination in the appeal was whether the circumstances were such that, had the arrangements taken the form of a contract between the Appellant and Pennyright Bank, the Appellant would be regarded for the purposes of the 1992 Act as employed in employed earner's employment by Pennyright Bank within the meaning of paragraph (c) of Regulation 6(1).

The evidence

6. Oral evidence was given by the Appellant on his own behalf. An agreed bundle of documents was produced. The Appellant produced three more documents in addition to those in the bundle.

The facts

7. The Appellant is a computer analyst and programmer. From 1982 he was employed by various companies. On 20 June 1988 he established a service company called E.B.Com Limited (E.B.COM) of which he and his wife were the directors. The Appellant then became self-employed. In the early 1990's there was an economic recession and the Appellant was out of work for nine months. This caused him hardship because, as a self-employed person, he did not receive unemployment benefits. The Appellant accepted work in Scotland but did not move his home there; he found the travelling between home and work to be inconvenient.

8. In 5 April 1994 the Appellant started working for Pennyright Bank whose premises were a half hour's drive from his home. He obtained the contract through an agency called Grinstead Associates (Grinstead). Pennyright Bank paid Grinstead who paid E.B.COM from whom the Appellant took his remuneration in the form of dividends. When the Appellant started to work for Pennyright Bank he was working on an old computer system that was to be replaced. Accordingly, he would not at that stage have been offered a permanent job with Pennyright Bank.

9. In 1996 E.B.COM bought out the contract with Grinstead for the sum of £5,460.00. Thereafter the Appellant continued to work for Pennyright Bank as a self-employed contractor directly through E.B.COM. In May 1999 Pennyright Bank wished to consolidate the procurement of all its self-employed contractors and did that through a company called Staff

Agency Limited (Staff Agency). Thereafter the contracts were between E.B.COM and Staff Agency; Pennyright Bank paid Staff Agency who paid E.B.COM from whom the Appellant received his remuneration.

10. The Appellant's contracts with Pennyright Bank were initially for six months and later for twelve months at a time. The contract in force at the relevant time was a consultancy agreement between Staff Agency and E.B.COM. Under that agreement E.B.COM agreed to procure that the Appellant would devote his time, attention, skill and ability in accordance with the requirements of Pennyright Bank at such location as Pennyright Bank might reasonably require. The agreement contained a special provision in the following terms;

"This agreement does not create the relationship of employer/employee between the company [Staff Agency Limited] or client [Pennyright Bank] and the contractor [E.B.COM] or any of its personnel [the Appellant] ... ."

11. At the relevant time the arrangements under which the Appellant worked for Pennyright Bank had the following features:

- E.B.COM agreed to assign to Pennyright Bank all intellectual property or other rights created during the performance of the Appellant's services.

- E.B.COM remained responsible for the Appellant's sickness, disability and pension arrangements.

- E.B.COM was only to be paid for time worked by the Appellant and not for sickness and holidays. Any absence of the Appellant had to be agreed and approved in advance by Pennyright Bank.

- Staff Agency could end the agreement at any time on giving four weeks notice to E.B.COM or with immediate effect if there were technical incompetence, unprofessional performance, unsuitability or misconduct of the Appellant.

- Responsibility for the quality, quantity, and performance of the services rested with Pennyright Bank at all times.

- The normal hours of work were seven hours a day and payment was of an hourly rate with overtime paid pro rata; reasonable travelling and subsistence expenses were also payable.

- If Pennyright Bank complained about the Appellant, or if the Appellant withdrew, Staff Agency would provide Pennyright Bank with a replacement.

- The equipment used by the Appellant was a mainframe computer system which was owned by Pennyright Bank and which was situated at Pennyright Bank's premises.

12. At Pennyright Bank's premises the Appellant worked in a large open plan office which accommodated about 55 people. As a self-employed contractor the Appellant did not have a job title. The Appellant managed a small group of seven, of whom two were self-employed contractors and the rest were permanent employees. The self-employed contractors were

mainly involved in project planning and the employees mainly supplied general production support. However, they all used the same equipment and the work was managed as a whole. The Appellant reported to a personal manager who was employed by Pennyright Bank. He had meetings with the personal manager to discuss how projects were going, whether he would meet his deadlines, and any other problems. The Appellant was the technology manager for his team. However, as a self-employed contractor he was not able to undertake any personnel management of the permanent employees. This was done by another employed manager who reported to the same person as the Appellant. The Appellant could express views about the performance of the employees in his team but the permanent manager formally reviewed their performance. Although the Appellant attended project meetings he did not attend other meetings arranged for permanent employees.

12. In April 2001 Pennyright Bank offered the Appellant a permanent position as an employee and he accepted that offer. He considered that it had many advantages. He would not be troubled by the IR35 legislation; he would obtain the benefits of private health insurance, sick pay, holiday pay and pension provision; he would have job security; he could manage the permanent employees in his team; and he would become involved in internal management and company decisions.

The arguments of the Appellant

14. The Appellant argued that he was not employed by Pennyright Bank. He argued that it was common in the computer industry for enhancement work to be undertaken by self-employed contractors and for support work to be undertaken by permanent staff. Employers preferred self-employed contractors because they could be laid off without severance pay. He took the risks of self-employment and he did not have any employment rights. Pennyright Bank could reduce his earnings without notice. He had had to renew his contract after each period of six months (or latterly each year) during the time he was self-employed. The Appellant emphasised that he ran his company properly and said that he paid an accountant £1,000 per year to perform the appropriate professional services to keep it in order. He distinguished his company from an "umbrella" company which was a single company out of which many contractors operated and where the contractors were not directors of the company. He argued that the IR35 legislation was more likely to apply to umbrella companies than to his own.

The arguments for the Respondent

13. For the Respondent Mr Williams argued that it was necessary to look at the substance of the arrangements rather than the form. The substance was that the Appellant was an employed earner. He had a personal obligation to Pennyright Bank and had been there for seven years. He supervised seven others, including employees, and in turn he was supervised by a personal manager. He was integrated into the structure of Pennyright Bank. Although in theory the Appellant could have been substituted by another employee, in practice that had never been done. The Appellant was not at risk of bad debts and he had not called a witness from Pennyright Bank to speak to the relationship. Mr Williams cited the authorities referred to later in this Decision and also Bank voor Handel en Scheepvaart N.V. v Administrator of Hungarian

Property (1952) 35 TC 311; Morren v Swinton and Pendlebury Borough Council [1965] 1 WLR 576; Massey v Crown Life Insurance Co [1978] 2 All E.R. 576; O'Kelly v Trust House Forte Plc [1984] QB 90; [1983] ICR 728; Carmichael and another v National Power plc [1999] 4 All ER 897; Express and Echo Publications Ltd v Tanton (1999) CA Transcript of 11 March 1999; MacFarlane and Skivington v Glasgow City Council EAT/1277/99 Transcript of 17 May 2000; O'Murphy v Hewlett-Packard Ltd Employment Tribunals Case 5300148/01 Transcript of 27 March 2001; and R (on the application of Professional Contractors Group Ltd and others) v Inland Revenue Commissioners [2001] STC 629.

Reasons for decision

14. Before considering the arguments of the parties it is convenient first to deal with a point made at the hearing by the Appellant with some force. The Appellant emphasised that people who supplied their services through service companies were not "tax fraudsters". He said that he had run E.B.COM for 14 years; all the money was accounted for in the books and he had paid all his income tax and value added tax. I have much sympathy with these comments. The Appellant, and his wife who assisted him, were honest, frank and open. There is no question in this appeal of any tax fraud. In this appeal the Inland Revenue do not dispute that the service company was run correctly, and that the right amounts of tax were paid, before the changes in the law which were effected by the 2000 Regulations. However, what has to be decided in this appeal is the effect of the changes made by the 2000 Regulations and, in particular, whether the Appellant now comes within the terms of Regulation 6(1)(c) of those Regulations.

The legislation

17. In considering the legislation I start with the 1992 Act. The definitions are in section 2 and the relevant parts provide:

"2(1) In this Part of this Act and Parts II to V below-

(a) "employed earner" means a person who is gainfully employed ... either under a contract of service, or in an office ... with emoluments chargeable to income tax under Schedule E; and

(b) "self-employed earner" means a person who is gainfully employed ... otherwise than in an employed earner's employment ... ."

15. The relevant parts of the new section 4A of the 1992 Act, as inserted by the Welfare Reform and Pensions Act 1999, provide:

"4A(1) Regulations may make provision for securing that where-

(a) an individual ("the worker") personally performs, or is under an obligation personally to perform, services for the purposes of a business carried on by another person (the client),

(b) the performance of those services by the worker is (within the meaning of the regulations) referable to arrangements involving a third

person (and not referable to any contract between the client and the worker), and

(c) the circumstances are such that, were the services to be performed by the worker under a contract between him and the client, he would be regarded for the purposes of the applicable provision of the Act as employed in employed earner's employment by the client,

relevant payments or benefits are, to the specified extent, to be treated for those purposes as earnings paid to the worker in respect of an employed earner's employment of his."

19. The relevant parts of the 2000 Regulations have already been referred to. To complete the legislative picture a reference should be made to the Social Security Contributions (Transfer of Functions, etc) Act 1999, which transferred the exercise of certain functions under the 1992 Act to the Board of Inland Revenue, and to Regulation 6(4) of the 2000 Regulations which provides:

"(4) Any issue whether the circumstances are such as are mentioned in paragraph 1(c) is an issue relating to contributions that is prescribed for the purposes of section 8(1)(m) of the Social Security Contributions (Transfer of Functions, etc) Act 1999 (decision by officer of the Board)."

The issue

20. The issue in the appeal is whether the circumstances were such that, had the arrangements taken the form of a contract between the Appellant and Pennyright Bank, the Appellant would be regarded for the purposes of the 1992 Act as employed in employed earner's employment by Pennyright Bank within the meaning of paragraph 6(1)(c) of the 2000 Regulations. The full text of Regulation 6(1)(c) is;

"(c) the circumstances are such that, had the arrangements taken the form of a contract between the worker and the client, the worker would be regarded for the purposes of Parts I to V of the Contributions and Benefits Act as employed in employed earner's employment by the client."

21. The 1992 Act defines an employed earner as a person who is gainfully employed either under a contract of service, or in an office ... with emoluments chargeable to income tax under Schedule E. As it was not argued that the Appellant was employed in an office, the issue is whether the Appellant would have been gainfully employed under a contract of service if his contract had been with Pennyright Bank and not with E.B.COM.

The authorities and the principles

22. The authorities establish the principle that the question as to whether a person is employed under a contract of service, or whether he is self-employed and provides a contract for services, is a question of fact in each case to be determined having regard to all the relevant circumstances.

23. In Ready Mixed Concrete (South East), Ltd v Minister of Pensions and National Insurance [1968] 2 QB 497 the issue was whether a worker was within the class of employed persons under the National Insurance Act 1965 as being an employed person under a contract of service. At page 515C MacKenna J said:

"A contract of service exists if these three conditions are fulfilled. (i) The servant agrees that, in consideration of a wage or other remuneration, he will provide his own work and skill in the performance of some service for his master. (ii) He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control in a sufficient degree to make that other master. (iii) The other provisions of the contract are consistent with its being a contract of service."

24. At page 515F MacKenna J added:

"Control includes the power of deciding the thing to be done, the way in which it shall be done, the means to be employed in doing it, the time when and the place where it shall be done."

MacKenna J then went on to identify a number of factors to be taken into account in deciding whether a contract was a contract of service. These included: whether the contractor hired his own employees; whether the contractor provided and maintained his own tools or equipment; whether the contractor was paid by reference to the volume of work done; whether the contractor had invested in the enterprise and bore the financial risk; whether the contractor had the opportunities of profit or the risk of loss; and whether the relationship was permanent.

26. In Market Investigations Ltd v Minister of Social Security [1968] 2 All E.R.732 Cooke J said that the fundamental test was whether a person performed services as a person in business on his own account. Although control was relevant it was not the sole determining factor; when one was dealing with a professional man, or a man of some particular skill and experience, there could be no question of the employer telling him how to do the work.

27. In Hall v Lorimer [1994] STC 23 the taxpayer was a vision mixer who undertook work for a number of different television production companies and whose engagements consisted of short term contracts lasting one to two days. In four years he worked on over 800 days. The Court of Appeal held that there was no single path to a correct decision. The question whether an individual was in business on his own account might be helpful but might be of little assistance in the case of one carrying on a profession or vocation. Factors which were critical in that appeal were the duration of the particular engagements and the number of people by whom the individual was engaged.

28. McManus v Griffiths (1997) 70 TC 218 established the principle that, in deciding whether a person was employed or self-employed, the task was to try to make legal sense of the arrangements made. Especially where the documents had not been drafted professionally, it was necessary to concentrate on the substance of the contractual arrangements rather then their form or the parties' labels.

29. Applying those principles to the facts of the present appeal I find that a number of factors point to the conclusion that, if the Appellant had been employed under a contract with Pennyright Bank, he would be regarded as gainfully employed under a contact of service. Such factors are:

- The Appellant did agree, in consideration of remuneration, to work a given number of hours a day and to provide his own work and skill to Pennyright Bank. Any absence of the Appellant had to be agreed and approved in advance by Pennyright Bank.

- The Appellant was a man of skill and experience and so it would not be expected that Pennyright Bank would tell him how to do his work; however, the Appellant was managed by a personal manager employed by Pennyright Bank.

- In the performance of his work the Appellant was subject to Pennyright Bank's control inasmuch as the contract provided that it could be ended for incompetence or misconduct and that responsibility for the quality, quantity and performance of the services rested with Pennyright Bank at all times.

- The Appellant did not hire his own employees; the members of his team were either self-employed contractors who had contracted directly with Pennyright Bank or permanent employees of Pennyright Bank.

- The Appellant did not provide and maintain his own tools and equipment; he used the mainframe computer owned by Pennyright Bank.

- The Appellant was not paid by reference to the volume of work done but by reference to the number of hours he worked.

- The Appellant did not invest in any enterprise and he did not bear any financial risk; he had no opportunity of profit and no risk of loss.

- The relationship between the Appellant and Pennyright Bank had an element of permanency as it lasted for seven years.

- The Appellant only provided work for Pennyright Bank and for no other client.

- The Appellant was integrated into the structure of Pennyright Bank to the extent that he worked closely with its employees.

30. On the other hand, some other factors point to the conclusion that, if the Appellant had been employed under a contract with Pennyright Bank, he would not be regarded as being gainfully employed under a contact of service but rather as providing services under a contract for services. Such factors are:

- After incorporating the service company, and before working for Pennyright Bank, the Appellant accepted the consequences of self-employment as he was unable to claim benefits when he was out of work. However, this was a consequence of the fact that his clients contracted with the service company. Under Regulation 6(1)(c) of the

2000 Regulations the assumption has to be made that the arrangements take the form of a contract between the Appellant and Pennyright Bank.

- The agreement between Staff Agency and E.B.COM provided specifically that it did not create the relationship of employer/employee between Pennyright Bank and the Appellant. However, such label given by the parties cannot be conclusive.

- Pennyright Bank was not obliged to pay the Appellant while he was sick or on holiday; the Appellant did not participate in Pennyright Bank's pension scheme nor did he receive private health insurance.

- In theory the Appellant did not enjoy job security as his contract could be terminated on four weeks' notice. However, in practice the Appellant worked for Pennyright Bank continuously for seven years.

- The Appellant did not participate in any management decisions at Pennyright Bank and could not manage permanent employees.

31. Having considered all the relevant factors I conclude that those which point towards there being a contract of service outweigh the factors which point towards there being a contract for services. Concentrating on the substance of the contractual arrangements rather than their form, I therefore conclude that, if the Appellant had been employed under a contract with Pennyright Bank, he would be regarded as being gainfully employed under a contact of service.

Decision

16. My decision on the issue for determination in the appeal is that, if the arrangements had taken the form of a contract between the Appellant and Pennyright Bank, the Appellant would be regarded for the purposes of the 1992 Act as employed in employed earner's employment by Pennyright Bank.

33. The appeal is, therefore, dismissed.

Chairman's name: use right arrow to move to starting point

DR NUALA BRICE

SPECIAL COMMISSIONER

SC 3079/2001