

# ***Dragonfly shot down in cold blood***

**Accounting web article – written by Steve Gretton, who heads up IESL's Employment Status/IR35 services.**

The PCG financed [the appeal](#) to the High Court believing (hoping?) that the decision at the Special Commissioners was wrong in fact and law.

## **Where we were**

The case was [initially heard](#) by Special Commissioner Charles Hellier. He found that Jon Bessell was a skilled computer system tester who provided his services via his own company, Dragonfly Consulting Ltd. He had a series of consecutive contracts via the agency, DPP, to The AA.

The work done was intrinsically the same throughout, working on a series of tasks as required by The AA. Jon worked under a team leader who had rights of control. Jon was to 'do the work allocated to him within the framework of the project timetable and be subject to the guidance of the team and its manager'.

Jon always provided his personal service. The Dragonfly/DPP contract had a limited right of substitution clause, but this was not reflected in the DPP/AA contract. Also it was clear that the managers at The AA had selected Jon personally and did not expect him to send a substitute. Also if Jon had actually tried to send a substitute 'that just would not happen' according to one manager.

There was no perceived financial risk or scope to increase the intrinsic profitability of Dragonfly, because the basis of payment was for time worked and there were no essential expenses imposed on Jon. The fundamental equipment was provided for him and his use of his own laptop was not fundamental to the work.

No significant argument was mounted against the Special Commissioner's conclusions about the existence of Mutuality of Obligation, the terms for terminating the contract, and other less significant status matters.

Mr Hellier provided a wonderfully clear analysis of the facts and the IR35 situation. (He also dealt with the MKM Computing case which went against the Revenue last year. Again a beautifully clear summary.)

## **At the High Court**

Four issues were argued before Mr Justice Henderson; the relevance of the concept of 'worker', intention, control and substitution/personal service. I do not propose to deal with the first two as nothing of great significance emerged. Suffice it to say that neither point was found in Dragonfly's favour.

### *Control*

It has always been the case that a person who is an expert is unlikely to be controlled as to 'how' he does the work. In other words, if someone knows how to undertake the task and is highly skilled, there may be little scope for the work provider to be able to control 'how' the work is done. However, that does not preclude the possibility that the work provider *could* retain the right to control 'how' the work is done.

The AA wanted to use Jon because he was an experienced expert who knew what he was doing. However, the contracts included terms that indicated that The AA could exert control and supervision rights. Also the managers said they could monitor Jon's work, could check it if there was a complaint, asking him to undertake certain tasks so they could check the quality of his work. The Judge approved Mr Hellier's description of this as 'an on-going informal appraisal of the quality of the work'. This, he said, is unlike a self-employed person where you would not expect to find such regular appraisal and monitoring.

Looking at the separate issue of control over 'what' was done, The AA allocated tasks to Jon, and progress was reviewed by the manager. Again quoting the Commissioner, 'the engagement

simply would not have worked if he did not do what was allocated to him' and he had to 'accept The AA's reasonable directions in relation to what he was doing (rather than how he did it)'. Little emerged about control over 'where' and 'when' the work was done, though the facts tended to support the concept of control by The AA rather than independence by Jon. The Judge again endorsed the Commissioner's comment that 'the degree of control was what one would expect in the case of a skilled professional employee, and pointed towards employment'.

This distinction between what is done and how it is done is useful. You could conclude that there was sufficient control simply by considering 'what' was done, but in this case it was reinforced by evidence that The AA could control 'how' the work was done as well, not to mention 'where' and 'when'.

This is not a ground-breaking conclusion, but rather a neat summing up of the situation. We can expect to see it quoted in future by HMRC.

### *Substitution*

This was the big issue and the one that has caused most squeals of anguish from contractors. One published contractor has said that because they can no longer rely on the substitution clause, 90% of contractors will be caught.

So what is significant? Firstly, in this case, all recent case law is gathered together. These days it is insufficient to simply insert a substitution clause without considering the strings attached. Everyone concerned needs to give more thought to all the documents and what happens in practice.

Take the previous case of *Synaptek* (quoted in *Dragonfly* with approval) where substitution was argued. A clause in the lower contract appeared to allow a right of substitution. But the effect of the clause itself was that 'unless and until agreed otherwise, the services have to be provided personally...'. In other words, the perceived right of substitution which depended on permission from the client was no right at all.

On the other hand substitution that has actually occurred more or less clinches the matter – provided that the worker pays the substitute.

Of course IR35 makes life more complicated because the hypothetical contract at the heart of the legislation is made up of at least three elements, and only one of them is the lower DPP/*Dragonfly* contract. The other elements include the upper DPP/AA contract and also the working arrangements in practice. The extent to which The AA would allow substitution is a significant part of 'the arrangements'.

What we find here is that the DPP/*Dragonfly* contract suggested substitution was on the cards and Jon Bessell relied on that. However the upper contract was silent on the point and the manager said it would not happen in practice. The Commissioner and the Judge had to decide which was correct and they sided with the manager.

This is what has caused the upset in this case and for PCG going forward.

It means that the reality for IR35 depends on what the manager, or others in authority at the end-client say, and not merely on what it says in the lower contract (which is all you have access to).

This is seriously scary. It's bad enough not having access to the upper contract. But if the outcome is only determined after an enquiry into what the managers would allow in practice, how on earth can anyone know in advance what the answer is?

### *Personal service*

The judgment also sets out a point that needs careful consideration. He drew attention to the requirement of The AA for Jon's personal service. He was chosen by The AA, he was named as the consultant in some of the documents. 'The AA did not want any competent tester, it wanted Mr Bessell'.

This phrase needs careful thought. If that is what The AA insisted on, then there is no possibility that substitution could occur. Substitution can only become possible if personal service is not a pre-requisite. The questions need to be asked in this order:

1. Does the end-client want a named worker? If so they require personal service and that is the end of the matter.

2. If the end-client is flexible, is there an unfettered substitution clause in the upper and lower contracts that really gives the worker freedom to substitute without reference to the end-client? That is what is needed to be sure.

### **What can be done?**

In the first place contractors and advisers need to accept that Dragonfly has considerably strengthened HMRC's hand in IR35. Woolly-worded lower-contract clauses about substitution which need permission to operate, or which find no reflection in the upper contract or in the end-client's thinking are ineffective.

Thus it becomes important for all parties to get their heads together and create coherent contracts and agreed methods of operation with honesty and transparency. Everyone needs to be involved, not just the intermediaries. After all, the end-client is keen to avoid taking on employees which is why they use agencies. Agencies are equally keen to avoid operating PAYE which is why they encourage the formation of intermediaries. Intermediaries and the workers are keen to avoid IR35 so they can benefit from paying profits out as dividends and thus reduce their Tax and NICs.

The agencies *must* play a bigger part in this because they are party to both the upper and lower contracts. The relevant sections from the upper contract *must* be made available to contractors. The commercially sensitive sections can be removed. All that we need to see is the bits that affect the terms under which the end-client wants the contractor to operate.

Of course, this may not be good news for contractors. It may become clear that the end-client actually does require personal service and does retain the right to allocate various tasks and possibly exert other control. But at least we could identify quickly the situations where this is not the case.

The bottom line, of course, is that HMRC will only pursue cases where they think substantial amounts of tax and NICs can be obtained. Thus if the intermediary is prepared to pay a bigger salary and smaller dividends, there is a significantly reduced risk of attack.

.