

Driven to distraction

Is HMRC's misfiring IR35 engine about to cause a pile-up, asks Dave Chaplin

Suppose your car engine repeatedly misfires after years of maintenance neglect, making it unsafe to drive. You pop it into the garage, but instead of the mechanics lifting the bonnet and fixing the engine, they repaint the vehicle and claim it's in much better shape. Would you be happy with that service? Probably not.

Well, that's the direction HMRC are heading after neglecting the underlying engine in their Check Employment Status for Tax (CEST) tool for years, having failed to deliver on its promise to Parliament to keep it updated with the law. Although the Court of Appeal laid down binding legal principles a year ago, highlighting that CEST's logic was wrong, CEST has not been fixed.

Instead, rumours are that CEST will receive a lick of paint but that the decision engine will stay tuned to HMRC's outdated 'policy view' of IR35 status. So, with the CEST engine remaining unreliable, what do the 40,000 private sector firms, who may still use it, need to watch out for?

Let's start from the beginning. What is CEST?

What is CEST?

HMRC's Check Employment Status for Tax (CEST) tool is a free online service designed to help organisations determine whether a worker should be classified as an employee or self-employed for tax purposes based on the details provided about their working arrangements. It was introduced as part of the off-payroll IR35 reforms (Chapter 10 ITEPA 2003), which rolled out to the public sector in 2017 and the private sector in 2021.

The importance of CEST being accurate cannot be stressed enough, particularly when tens of thousands of firms are relying on CEST to get their determinations correct, failure of which could lead to financial ruin for a firm. HMRC have already issued tax bills of over £250m to Government organisations that relied on CEST and HMRC's guidance.

Has HMRC updated CEST in line with the emerging case law?

Despite Jim Harra, Chief Executive and First Permanent Secretary for HMRC, promising the Public Accounts Committee on 21 February 2022 that CEST would be adjusted as the case law develops, CEST's underlying decision engine hasn't been updated since 24 October 2019.

Since CEST's last update, 16 IR35 tax tribunal decisions have been published, and yet not one change has been made to the underlying CEST engine. The failure to deliver the maintenance promise is even more surprising given the seminal decision of HMRC v Atholl House Productions Ltd [2022] EWCA Civ 501, published by the Court of Appeal almost a year ago on 26 April 2022.

The Atholl House decision set a precedent for many of the now-binding legal principles to determine tax status, having rejected many submissions from HMRC, which proved beyond doubt that their longstanding 'policy view' on status matters, upon which CEST was built, was fundamentally wrong.

So, CEST has not been kept in line with the case law. So, what's broken?

What's broken with CEST?

To understand the CEST faults, let's refer to Atholl House and some of the rejected submissions made by HMRC Counsel:

- Make multi-factorial determinations: HMRC claimed a prima facie conclusion of employment should be drawn if there is personal service and a sufficient framework of control before considering other factors. The judges dismissed this submission and confirmed that a full multi-factorial determination should always be undertaken.
- Do not be myopic: HMRC claimed that when considering other factors, including being in business on one's own account, that only the terms of the contract should be considered, and matters outside the contract should be ignored. The judges rejected this notion, referring to the suggested approach as 'myopic'.
- The extent of control is important: HMRC claimed that any conclusions on mutuality of obligation and control should not be revisited at the third stage of the status evaluation. The judges dismissed this notion, saying extent and sufficiency are relevant factors.

As a practitioner of IR35 enquiry work, it's clear HMRC has been running a narrow 'policy view' for years, aligned to the failed submissions made in Atholl House, which CEST still uses.

But it gets worse. Look under the CEST bonnet and analyse the algorithm (all publicly available online). You will also discover that in 99% of cases where CEST concludes 'outside IR35', CEST has not conducted a multi-factorial determination. If you tell CEST you can substitute or that there is hardly any control, it will ignore all further information given, having already concluded IR35 does not apply.

Outside IR35 determinations given by CEST present a considerable risk for firms for three primary reasons:

- The exit doors method for substitution and control contradicts binding law because no multi-factorial determination has been made.
- An unexercised right of substitution isn't worth a row of beans if other factors indicate that a contract's 'dominant purpose' is one of service, as per the Supreme Court decision in *Pimlico Plumbers Ltd & Anor v Smith* [2018] UKSC 29.
- HMRC will claim a sufficient framework of control on the flimsiest levels of control - for example, the mere existence of editorial guidelines.

The danger for firms is amplified by considering what happens if the exit doors don't open. CEST will deliver a multi-factorial determination – but in 99% of cases, it will tell you that the engagement is either 'Unable to determine' or 'Inside IR35'. The reality is that CEST's 'Outside IR35' determinations are wholly unsafe.

So, with CEST misaligned with case law, is it careless to use it?

Does using CEST meet the requirement for reasonable care?

The off-payroll working legislation contains the concept of a Status Determination Statement (SDS), which is created by the client and given to the worker, conveying the IR35 status of the engagement. The CEST results screen enables users to print an SDS.

But these SDSs are only valid if reasonable care is taken in coming to the status conclusion in the statement. To understand more about reasonable care, we can read the HMRC off-payroll guidance in ESM10014, which lists behaviours that HMRC consider do not constitute reasonable care, which includes “failing to take account of all relevant evidence”.

Well, isn't failing to take account of all the relevant evidence exactly what CEST does when it concludes 'outside IR35' determinations? Drop the mic.

So, with CEST currently misaligned with the law and using it is arguably careless, what should happen next?

What should HMRC do with CEST?

With the CEST engine steering users carelessly to unsafe outside IR35 conclusions, you would expect HMRC to warn users, but alas no. Recent enforcement letters sent to firms by the HMRC specialist status teams ask firms to use CEST within 30 days and retain copies of any decisions taken. But don't be fooled. CEST is not mandatory, nor does it have any legal authority.

CEST is currently a wreck, and HMRC's repeated failures to update the tool or warn businesses of its known shortcomings are reckless. CEST either needs a 'beware' sign stuck on it, or it should be towed away and scrapped to prevent damage to businesses unwittingly relying on its overblown claims of credibility.

The HMRC press office needs to stop issuing words akin to: “HMRC has been repeatedly assured that CEST has been robustly tested and has been aligned with the rules and guidance at all times.” Those assurances don't hold much weight in the modern post-Boris Johnson era.

In the meantime, until CEST is fixed, don't risk losing your business by playing the CEST game. The best way to win at CEST is not to play at all.

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