IR35 and CEST

Employment Tax | Tax voice



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Steve Wade identifies a range of issues with the HMRC Check Employment Status for Tax (CEST) tool

The 2018 budget release stated that:

“To increase compliance with the existing off-payroll working rules (known as IR35) in the private sector, businesses will become responsible for assessing an individual’s employment status.”

As this reform had been introduced to the public sector from 6 April 2017, it was anticipated that the reform would apply from 6 April 2019 but, following

representations, the reform was delayed to 6 April 2020 and will not apply to the smallest 1.5 million businesses. The definition of a small business and other issues are to be the subject of a consultation later this year.

HMRC developed a CEST tool to help engagers make employment status determinations. (CEST standing for Check Employment Status for Tax.)

What does CEST do?

In HMRC's words it is possible to *"Use this service to find out if you, or a worker on a specific engagement, should be classed as employed or self-employed for tax purposes."*

The tool gives HMRC's view in respect of a particular engagement whether:

1. The IR35 rules apply;
2. The off-payroll working in the Public Sector rules apply; and
3. A worker should pay tax under PAYE.

HMRC agrees to stand by the output from the CEST tool, provided accurate information is entered. Clearly, where the information is incorrect or has been manipulated to achieve a particular outcome, then HMRC would not stand by the decision. For further detail see HMRC Guidance – Check Employment Status for Tax).

Can CEST be relied on as tool for determining employment status?

Statistics published by HMRC suggest that the tool arrives at a conclusion in 85% of the cases, with 15% of cases requiring further review. HMRC hope to be able to reduce the number of inconclusive results before the extension of the rules to the private sector.

There has been much debate between HMRC and practitioners around the accuracy of the decisions from the CEST tool, especially during the rollout for the Public Sector. The decision-making questions that drive the determination in CEST for example, do not consider Mutuality Of Obligation (MOO). At the IR35 forum held on 11 December 2017, HMRC confirmed that the tool was designed to examine whether an:

“existing or future contract will be one of employment or self-employment.”

HMRC’s view was that mutuality of obligation should already be in point when CEST is being used to determine employment status, as this is necessary for a contract to exist. HMRC now are consulting on improvements to the tool including MOO before the extension of the rules to the private sector (see also IR35 Forum Notes – HM Revenue and Customs Paper on Mutuality of Obligation).

Other challenges identified with the tool are that it heavily relies on the responses provided around the right of substitution, specifically, where it is marked as being enforceable and genuine. The tool does not probe further and the answers can lead to an incorrect determination.

The approach of the courts

Doubts as to the effectiveness of the tool have also been driven by the Courts finding against HMRC in a number of cases. A concern expressed in the market has been that if HMRC’s views differs from the Courts’ view how can HMRC build an effective tool. However, the Courts or rather Judges are not computers. In the Lorimer case (*Hall v Lorimer* [1994] 1 All ER 250) it was stated that:

“in cases of this sort there is no single path to a correct decision. An approach which suits the facts and arguments in one case maybe unhelpful in another.”

and

“This is not a mechanical exercise of running through items on a checklist to see whether they 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 the evaluation of the overall effect of the detail, which is not necessarily the same as a sum total of the individual details. Not all details are equal weight or important in any given situation. The details may also vary in importance from one situation to another.”

“Standing back” to consider all the circumstances may be a fair approach but isn’t one that can be simply programmed. By way of contrast the CEST tool uses a limited number of questions to provide a determination.

Conclusion

The debate and consultation around the validity and accuracy of the CEST tool continues, albeit in the simpler cases the tool is appropriate and can be relied upon. Since the time of drafting this article HMRC have published the consultation on "off-payroll working rules from April 2020". This contained a section on CEST and acknowledges concerns about "*CEST's ability to:*

- *take account of existing employment status for tax case law and the resulting possibility to not give an accurate employment status determination in some cases*
- *reflect the complex nature of the private sector."*

HMRC's response is *"to*

- *enhance the service to help customers make employment status decisions;*
- *improve CEST guidance so organisations can confidently make employment status determinations that people working through intermediaries will be able to see and understand*
- *develop an education and support package for those affected to help them prepare for, and implement changes to the off-payroll working rules."*

When engagers are relying on the CEST result they should ensure they have a full audit trail including the CEST determination and why they answered the questions in the way they did.

The risk, however, is that the current tool may be too simplistic, not focus on sector specific detail, for example, and not be able to reach a correct determination in all cases. Engagers who disagree with a result should also keep a full audit trail highlighting why they disagree. When CEST is inconclusive they should consider taking professional advice.