Harbron Recruit Ltd: the definition of employment

Employment Tax



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We look at case which blurs the distinction between employment and self-employment.

Key Points

What is the issue?

Harbron Recruit Ltd faced issues with the Construction Industry Scheme (CIS) rules. It sourced workers through agencies and historically treated these agencies as subcontractors, applying CIS rules. However, changes in the law in 2014 required workers to be treated as employees for tax purposes if they were under supervision, direction or control, complicating the company’s tax obligations.

What does it mean to me?

In 2020, HMRC investigated Harbron for non-compliance with CIS rules, proposing a significant tax charge. Harbron sought relief under Regulation 9, arguing they took reasonable care and that any failure was due to a genuine belief that the rules did not apply.

What can I take away?

The case highlights the ongoing need for care with regards to the CIS rules. Companies involved in implementing the CIS rules should obtain expert advice, as the rules can be complex and have significant financial implications.

I remember Lord Carnwath (then ‘a “mere” Lord Justice’) addressing the London Branch of the CIOT back in about 2008. He pointed out how much of tax law treats pairs of concepts as fundamentally different and irreconcilable (such as ‘employed versus self-employed’ and ‘capital versus income’); whereas, in the real world, cases often arise where a set of facts could lead to either conclusion being reached.

When we have correctly categorised a particular situation, however, then at least the tax treatment should be relatively clear. For example, income is either from an employment, in which case the rules in the Income Tax (Earnings and Pensions) Act (ITEPA) 2003 and the PAYE regulations apply, or it is from self-employment, in which case the Income Tax (Trading and Other Income) Act 2005 code becomes relevant – and, perhaps more relevantly, the ITEPA 2003 and PAYE rules can be set to one side.

However, as the recent case of *Harbron Recruit Ltd v HMRC* [2025] UKFTT 23 (TC) demonstrates, there are some cases where it is dangerous to rely on this apparent dichotomy.

The facts of the case

The company, Harbron Recruit Ltd (Harbron), operates in the construction industry sector. Its business is to provide workers for other businesses that actually carry out construction work. At all relevant times, Harbron sourced the workers from agencies who then ‘on’ supplied the workers to the construction businesses via the company.

Historically, Harbron treated the agencies as its own subcontractors. Therefore, it would apply the Construction Industry Scheme (CIS) rules (currently found in the

Finance Act 2004 Part 3 Chapter 3) on its own payments to the agencies. This meant that it would effect a deduction from its payments to the agencies unless the agencies were themselves registered to receive such payments gross (as per the provisions of Finance Act 2004 s 60).

The situation changed, however, following the substitution of ITEPA 2003 s 44, which came into effect from 6 April 2014. This tightened up the rules in cases involving the supply of workers by agencies. Provided that the worker is under a person's supervision, direction or control (or is subject to the right of such supervision, direction or control), then the worker is to be treated as an employee of the agency for income tax purposes. Accordingly, all remuneration received by the worker in consequence of providing those services is to be treated for income tax purposes as earnings from that employment. Similar changes were made in relation to NICs.

A number of matters specific to the company also arose around the same time as the Finance Act 2014 rules came into force. First, the managing director's mother (who had previously operated the company's CIS compliance) retired for health reasons and two other members of the company's finance staff left the company. As a result, the managing director instructed a local and well-respected firm to help him carry out the CIS compliance, as well as to assist the company recruit and interview new staff with the appropriate finance skills.

Furthermore, as a result of the changes in the rules, the company received a large number of marketing newsletters giving warnings about the risk of non-compliance with the new rules. In particular, the company was warned that leaving workers within the CIS scheme and failing to deduct the sums due under the PAYE and NIC rules would risk leaving the company exposed to the PAYE and NIC under-deductions. As a result, the company instructed a large regional firm of accountants with specialist knowledge of the CIS to provide advice on the company's ongoing CIS obligations in the light of the new rules.

As a result of the advice given, the company's director understood that the workers would all be taxed under PAYE on their earnings and that, accordingly, the company did not need to apply any deductions under the CIS in relation to its payments to the agencies. With effect from the beginning of the 2017/18 tax year, the company then started to make nil returns for CIS purposes.

In May 2017 (a few days after the company's first nil return), HMRC opened an investigation into the company's CIS compliance but this was quickly shut down with no further action being taken.

However, in October 2020, HMRC again started to investigate the company's compliance, this time citing the PAYE, VAT and CIS rules. On 8 March 2021, a 'warning letter' was issued advising Harbron that HMRC was proposing to charge the company over £480,000 in relation to income tax that should have been deducted under the CIS rules. HMRC's warning letter was anticipating a determination under Regulation 13 of the Income Tax (Construction Industry Scheme) Regulations 2005. In response, the company sought a direction that would excuse it from liability for any underpaid tax under the provisions in Regulation 9.

There are two statutory bases for a contractor's application for relief under Regulation 9:

- Condition A applies if the contractor can show that reasonable care was taken to comply with the CIS deduction rules and that any failure was down to either an error made in good faith or a genuine belief that the deduction rules did not apply.
- Condition B applies if the payments have been appropriately taxed upon by receipt the payee – in other words, there has been no real loss of tax.

The whole purpose of the CIS rules was to address concern that payments made to subcontractors in the construction industry were not being properly accounted for with regards to tax by the subcontractors. As a result, the CIS rules seek to ensure that an approximation of the eventual tax liability is deducted at source so as to reduce the impact of any non-compliance further along the contractual chain. As a result, in cases where the tax has eventually been accounted for by the subcontractor, there is no need for the Exchequer to effect a double recovery.

In response to the company's application, HMRC reduced the amount in question by just under £130,000 in accordance with Condition B. That related to the payments made to one of the agencies with which the company had worked. However, HMRC did not accept that Condition A applied. In accordance with the provisions in Regulation 9(7), Harbron then appealed against the 'refusal notice', arguing that the terms of Condition A were in fact satisfied.

In the course of its internal review, HMRC advised Harbron that the refusal notice was issued because it did not consider that ‘the company had met the requirement at Regulation 9(3)(a) of the CIS Regulations that reasonable care had been taken to comply with … the CIS regulations’.

Harbron’s appeal was then duly notified to the First-tier Tribunal.

The First-tier Tribunal’s decision

The case came before Judge Anne Redston.

By the time that the judge considered the case, the parties were agreed that HMRC was technically correct. Although the agency rules meant that the workers were deemed to be employees of the agencies (and therefore were required to have PAYE and NIC deducted from the payments made to them by the agencies), this did not exempt the company’s payments to the agencies from still being liable to deductions under the CIS rules.

The judge also acknowledged that the company had no right of appeal against any refusal notice so far as it relates to Condition B. Thus, the judge’s decision focused on Condition A.

She quickly dismissed HMRC’s arguments which sought to argue that ignorance of the law cannot amount to a defence. Although HMRC argued that ‘the tribunal has routinely [expressed or endorsed] that view’, the judge pointed out that that was not true. Indeed, the Upper Tribunal put it beyond doubt in *Perrin v HMRC* [2018] UKUT 156 (TCC) that the defence of ignorance of the law *can* be a defence, provided that the circumstances warrant it.

HMRC had also relied on the fact that HMRC’s own CIS guidance made it clear that agencies come within the scope of subcontractors for the purposes of the CIS rules, meaning that payments to agencies can be liable to deduction under the rules. However, the judge pointed out that the same guidance made it clear that the CIS rules do not apply to employees and that, when agencies are involved, the workers should almost invariably be treated as employees.

The judge also observed that some of HMRC’s own arguments revealed a lack of understanding as to how the rules operated, which served to ‘support [the

company’s] case that the interaction between the two sets of rules is not straightforward’.

Finally, the judge said she had ‘no hesitation’ in agreeing with Harbron that it had acted with the level of care which a reasonable person in the company’s position would have showed. In particular, the interaction of the two sets of rules was technically complicated, and Harbron acted reasonably when it properly instructed two reputable firms with the relevant expertise to assist it. Furthermore, Harbron had expressly sought advice not just on the PAYE/NIC side but also in relation to the CIS rules.

Thus, although Harbron had mistakenly failed to deduct tax under the CIS, it had taken reasonable care.

In addition, the judge commented on a further point. In HMRC’s Statement of Case, it was pointed out that the reason that the refusal notice was given in relation to Condition A was solely because HMRC had concluded that Harbron had failed to take reasonable care. HMRC argued that if the company was successful on that point, as indeed proved to be the case, the tribunal should remit the case back to HMRC so that it can then decide whether the other limb of Condition A was satisfied (being that any failure was down either to an error made in good faith or to a genuine belief that the deduction rules did not apply).

However, the judge considered that to be inappropriate. In particular, she noted that Regulation 9(6), which governs refusal notices, requires HMRC to state ‘the grounds for refusal’. The correspondence between the parties indicated that the ‘grounds’ were, in fact, the singular one, being the assertion that the company had failed to take reasonable care. In any event, the judge concluded that the regulation did not support the idea that HMRC is permitted to issue a succession of refusal notices covering different aspects of Condition A.

As the company was successful in relation to the only part of Condition A that was in dispute, the company’s appeal was allowed.

Commentary

It is hard to see any fault with the judge’s decision in this case. However, the case does highlight a number of different issues of interest. As someone who does not

regularly work with the construction industry, I must admit to having wondered whether, unlike the early 1970s when the CIS was first introduced, the industry still needed a special scheme to combat non-compliance. However, the figures in this case were an eye-opener. HMRC's decision in relation to Condition B showed that one of the agencies used (and used only in the 2017/18 tax year) had accounted for corporation tax in relation to all the payments made by the company. As for the four other agencies used across the four tax years under review, HMRC's conclusion on Condition B indicates that some £354,162 has gone missing in the system. There can of course be multiple reasons for that money not being accounted for. However, my previous view has certainly changed and I can now see at least a good *prima facie* case for the rules remaining in place.

That does, however, lead to two further points.

First, how did so much go missing? Could HMRC have done more (and sooner) so as to stop these tax leakages from occurring? Why was there a gap of over three years between HMRC's first (albeit aborted) intervention and its second investigation?

Secondly, in relation to the £129,000 that had been properly accounted for, what would have happened had the company not asked for relief under Regulation 9? In that case, Harbron would have been liable for that £129,000 even though that sum had been fully accounted for further down the contractual chain. That would have given HMRC a double-recovery. Should HMRC not be required to take steps to avoid that without taxpayers expressly asking for it?

What to do next

If you have a client that operates in the construction industry, this case should serve as a clear reminder that deductions under the CIS might still be due even though the worker is treated as an employee for tax purposes under the agency rules. The rules have been judicially described as complex. In such circumstances, it is advisable for taxpayers to obtain suitable expert advice.

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