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The Reed Employment Case: Part 2

David Kirk reviews over-arching contracts of employment.

In part 1 of my analysis of the Reed case (see TPT August(1) 2102) we saw how Reed Employment Plc lost a very considerable sum of money because its salary sacrifice scheme was ineffective. However, the tax tribunal also held that a sum payable by way of expenses came within ITEPA 2003, s 70 not s 62, and so was eligible for a dispensation. Reed had been operating a scheme for its temporary workers with the intention of getting their travelling expenses out of PAYE, and had been given dispensations to that effect, the final one of which was revoked.

Over-arching contracts

Had Reed won on the salary sacrifice there was another reason why the expenses would still not have been deductible: because the tribunal held that the temps' workplaces were permanent (so the travel was ordinary commuting and not deductible) rather than temporary (allowable deduction for travel costs). This was because their contracts were not over-arching, and so when one assignment came to an end, so did their employment at that workplace.

Traditionally, agency workers have not been employees (but subject to PAYE due to the agency rules in ITEPA 2003, ss 44-47), and for this reason a contract comes to an end when an assignment does. However Reed had made their temps employees. Their schemes were rather convoluted and it seems that at least in one case the Tribunal judges did not fully understand them. The judgment contains overtones of; 'If we can't understand it, the employees could not possibly have done so either, and so they were not giving their informed consent to it.'

The First-tier tribunal identified nine issues, the first two of which were covered in part 1. We now move on to issues 3 to 9.

3: Permanent or temporary workplaces?

It is here the judgment becomes really controversial, in finding that the temps' contracts were contracts of employment while they were on assignment and not while they were not. There has always been a dichotomy between umbrella contracts and day-to-day assignments, and in tax cases one has to look at both possibilities to see whether there is an employed relationship. Sometimes there are both types of contract, but the courts are loathe to infer the existence of one type where the other indubitably exists. In this case there was unquestionably only one contract, and this idea of a contract changing its spots is, as far as I know, completely novel.

It is quite true that ITEPA 2003, s 4 states that employment includes 'any employment under a contract of service', thus opening up the possibility of there being one contract with more than one employment. However, this tack is open to two very important objections:

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- The judges failed to comment on a section of Reed's contract, that in fact negates an employed relationship during the times even when the temps are on assignment (contrary to what both parties were maintaining). The contract says the temps are working for and under the control of Reed's clients, thus negating the requirements both of control by the employer and mutuality of obligation;
- It suggests that the meaning of 'employment' is different in tax law from that in employment law, where a break between assignments might pose a problem in an unfair dismissal claim or even a reduced payout in a redundancy. The whole tendency of employment law, and one backed by more senior judges, is not to allow devices like these to let employers off the hook, and so it will not allow for these gaps.

This conclusion looks distinctly questionable.

4: Lawful dispensations?

The judges point out that if a Revenue officer is satisfied that no extra tax is payable by virtue of the listed provision, then he **must** issue a dispensation under ITEPA 2003 s 65(3). Here what the tribunal found is unimpeachable in law, but could cause problems. A dispensation can only be given in respect of payments and benefits under the listed provisions, which include ITEPA 2003 s 70 expenses. It follows that as they have found the earnings in question to be ITEPA 2003, s 62 earnings, a dispensation cannot be granted for them and so the ones that were granted were not valid. However, had they been s 70 expenses then the dispensation would have been valid even if wrongly granted – that is, for example, if the inspector had misunderstood the position and extra tax was payable. HMRC's remedy here is to revoke the dispensation, retrospectively if need be.

5: Did the dispensations cover the allowances?

Following on from the earlier issues, the short answer is no, because a dispensation cannot cover s 62 payments. Had they been s 70 expense payments, it would have been different. As the judges put it: 'If HMRC were wrong in considering that the listed provisions apply then, for the reasons already given, the dispensation had no effect; but if they were wrong for any other reason the dispensations had effect (though subject to HMRC's right of revocation).'

6: What is the effect of a dispensation?

The judges found this was three-fold: it relieves the employer of the obligation to deduct tax; it removes the requirements to report expenses and benefits on form P11D; and it extinguishes altogether a liability to tax that might otherwise be there.

This last point is problematic. HMRC need to be seen to be fair when collecting tax. If HMRC discover they have granted a dispensation in error it would follow that they should revoke it automatically and retrospectively, as they have no other way of collecting tax that is lawfully due. Otherwise they are granting a favour to one employer by granting a dispensation, as opposed to another employer who never applies for one. One may be grateful that they apply this kind of sanction pragmatically.

Issue no. 7 was about Reed's legitimate expectation, on which the tribunal did not have jurisdiction to decide; it is therefore not covered here.

8: Was Reed obliged to deduct PAYE?

Obviously yes, as the payments were ITEPA 2003, s 62 earnings. More difficult to follow is the judges' statement that this would also be true if they had been s 70 payments, as 'they did not meet expenditure for which the employed temps could properly claim relief'. Does this not contradict their statement in issue no. 6 that a liability to tax is extinguished?

9: Same outcome for tax and NIC's?

The judges say 'yes', and on this issue I maintain with complete confidence that they will be overturned (if the issue is addressed on appeal at all). The effect of it is: if an employer fails to apply for a dispensation then he and his employees are going to pay more in NIC's than they need to. Whereas for tax an employee can make a claim for a deduction, on a tax return or form P87, he has no such remedy in the case of NIC's, and nor does the employer.

In fact NIC's are only levied on 'earnings' (SSCBA 1992, s 3); these may not mean quite the same as earnings in ITEPA 2003, s 62 but they must be pretty similar. *S & U Stores Ltd v Wilkes* [1974] 3 All ER 401 would suggest that expenses are included to the extent that there is an element of profit to the employee, but not otherwise. In any case, a whole raft of expense payments are specifically excluded by virtue of the Social Security (Contributions) Regulations 2001, sch 3. What is certain is that dispensations only cover PAYE – there is no mention of them in National Insurance legislation.

Conclusion

This judgment is a troubling one in one respect – its novel idea of a contract changing its character as time goes on – and a puzzling one in its approach to dispensations. Whilst its contention that a dispensation cannot cover ITEPA 2003, s 62 earnings looks unimpeachable, it leaves answers insufficiently explained as to why they can cover ITEPA 2003, s 70 expenses payments, and yet leave a liability to tax on the part of someone who pays ordinary commuting expenses. HMRC's remedy of a revocation, even with retrospective effect, is onerous, because if someone has been paying both qualifying travelling expenses and ordinary commuting expenses it is hard to see how a revocation could fail to affect both of them, and that would be unjust. I hope more clarity comes from this in the Upper Tribunal. **TPT**

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