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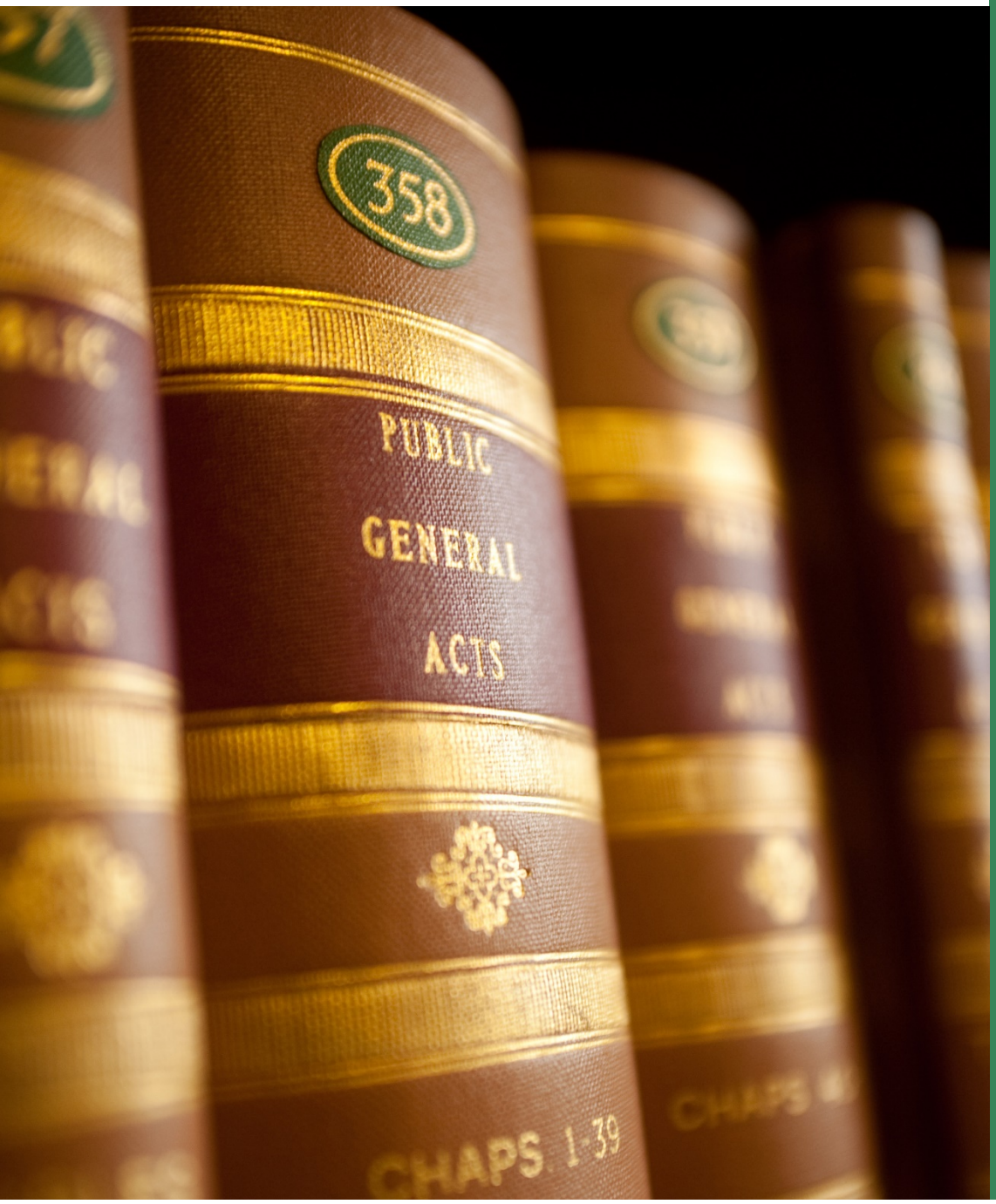
Self-employment in the construction industry

By Antony Seely



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The question whether someone is employed or self-employed is an important one, both in relation to tax, and to an individual's rights in employment law. For some years there have been concerns about the scale of 'false self-employment' in the construction sector: individuals engaged on the basis that they are self-employed, but who are working under employment terms.

Employers classifying workers this way may avoid being charged National Insurance contributions (NICs) on the earnings they pay. Individuals may also make a tax saving, although they may be unaware of the benefits they will lose from not being classed as an employee (such as their rights to sick pay.) In the 2009 Budget the Labour Government announced that it would "consult with a view to future legislation to ensure that construction workers and those they work for are taxed appropriately."[1] A consultation document was published in July that year. The proposals proved quite controversial, and were not proceeded with.[2]

More recently there have been concerns about intermediary companies exploiting these rules, disguising the nature of the contract for workers they place with employers, and, in some cases, sharing most if not all of the financial benefits with the employer, with little benefit for the individual worker. Following consultation, in the 2014 Budget the Coalition Government announced measures to tackle the activities of employment intermediaries avoiding tax, either by being based offshore, or, of particular relevance to the construction industry, by disguising employment as self-employment.[3]

Over the last two years there has been a much wider debate about self-employment, particularly in relation to the 'gig economy', and whether the tests for determining employment status should be reformed.[4] There has also been debate as to whether the different tax treatment of income from self-employment compared with income from employment is fair, leading to the Government announcing in the March 2017 Budget major reforms to Class 4 National Insurance contributions (NICs) paid by the self-employed. In the latter case, the Chancellor Philip Hammond withdrew these proposals several days after the Budget, and the Government has stated that it has no plans to revisit the issue.[5] In February 2018 the Government published its response to a review of working practices it had commissioned from Matthew Taylor, and as part of this, launched a consultation on employment status.[6] The consultation looks at employment status both with regards to employment law and tax, but does not consider any changes to the rates and reliefs for either income tax or NICs.

This note gives some background to the question of employment status and the difficulties it has caused in the taxation of the construction sector, before discussing initiatives by both the Labour Government in 2009 and the Coalition Government in 2014, and more recent debates as to the possibility of a longer-term solution to this issue.

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1 *Budget 2009*, HC 407, April 2009 para 5.114

2 The 2010 Budget report simply stated that the Government "remained committed to addressing this problem" (*Budget 2010*, HC 451, March 2010 para 5.94). Details of the consultation are collated on the National Archives site.

3 HM Treasury, *Overview of tax legislation & rates*, March 2014 para 1.55-6. Provision to this effect was made by ss16-18 & s20 of *FA2014*. It was estimated these changes would raise £80m, and £445m, in 2014/15, respectively (*Budget 2014*, HC1104, March 2014 pp58-9 – Table 2.2 items s & bb).

4 see, *Employment status*, Commons Briefing paper CBP8045, 28 March 2018.

5 see, *National Insurance Contributions (NICs) and the self-employed*, CBP7918, 7 September 2018

6 Details are on Gov.uk. The consultation closed on 1 June 2018, and the Government has not published a response as yet.

1. Introduction

1.1 Employment status for tax law

Employment status is the classification of a working relationship between a person providing work and a person carrying out that work. An individual's employment status has important implications for their taxation, both in relation to income tax and to National Insurance contributions (NICs). Tax law distinguishes between employees and the self-employed - someone working for their own unincorporated business as a self-employed sole trader or a partnership.

Employees will pay income tax and primary Class 1 NICs on their earnings, deducted at source by their employer under PAYE. Their employer will be liable to pay secondary Class 1 NICs on the employee's earnings. By contrast, self-employed persons providing their services to a client company will receive any payments gross of tax, and be responsible for paying income tax and NICs on their annual profits. Profits from self-employment are liable to Class 2 and Class 4 NICs.

It is important to make the distinction between individuals running their own unincorporated business and an incorporated business or company. In recent years a significant number of individuals have established their own limited liability company that they run as a company owner-manager. While these two groups are often considered together, there are important differences in their treatment by tax and legal systems – so that, in the case of incorporated companies, the profits the company makes are liable to corporation tax, while its employees will be liable for income tax and NICs on their earnings.[7]

There is no statutory test to determine employment status for tax purposes. The question whether someone is employed or self-employed is determined on the basis of criteria established by judicial decisions. It is important to note that individuals do not have the choice over whether they should be classed as employed or self-employed. Similarly the parties to a contract cannot simply declare what that person's employment status should be. Such a declaration would be no more than labelling, and cannot alter the underlying relationship between the parties concerned.

With regard to **income tax**, section 4 of the *Income Tax (Earnings & Pensions) Act (ITEPA) 2003* states that "employment" is to *include* "any employment under a contract of service, any employment under a contract of apprenticeship, and, any employment in the service of the Crown." The explanatory notes to the Act explain why the legislation adopts this approach:

> The decisions of the courts have given rise to a number of different tests, none of which has proved to be definitive. Given the diversity of approach in the courts it seems unlikely that an exhaustive definition of 'employment' could be produced, or indeed that one could produce more than an incomplete list of

[7] For further details on these legal forms and their tax treatment see, *Tax, legal form and the gig economy*, Institute for Fiscal Studies, February 2017.

> criteria that might or might not be useful in a given case for determining whether employment exists.
>
> On the other hand it is thought that it would be helpful to have a non-exhaustive explanation which gave an indication of the *core* meaning of 'employment' by listing certain arrangements that on any view constitute an employment. As such, it would not attempt to delineate the boundary between employment and self-employment.[8]

This definition is used in determining whether payments made by an employer should be taxed under PAYE.[9] In one leading case in this area, the tribunal noted, *ITEPA 2003* "affords no further definition of [employment], and it is common ground that recourse must be had to the common law's understanding of the meaning of employment, and of contract of service, and in particular, the well-established distinction between those concepts and self-employment, independent contractor and contract for services."[10] *Revenue Law*, a standard legal text, notes that this definition "leaves open the most significant question: when is there a contract of service? Note the common terminological distinction between a contract of service (employment) and a contract to provide services (self-employment), which is sometimes collapsed to simply the distinction between 'service' and 'services' – a subtle different that is ripe to cause confusion."[11]

With regard to **National Insurance contributions**, section 2(1) of the *Social Security Contributions and Benefits Act (SSCBA) 1992* distinguishes between "employed earners" and "self-employed earners", defining these terms as follows:

> "employed earner" means a person who is gainfully employed in Great Britain either under a contract of service, or in an office (including elective office) with general earnings
>
> "self-employed earner" means a person who is gainfully employed in Great Britain otherwise than in employed earner's employment (whether or not he is also employed in such employment).

Further to this, s122(1) of *SSCBA 1992* defines a "contract of service" as "any contract of service of apprenticeship whether written or oral and whether express or implied." As with income tax, the crucial question is whether an engagement is a contract of services, or a contract for services.

In a report on employment status published in 2015, the Office for Tax Simplification (OTS) found that "there appears to be a general perception … that the classification of an individual's status for either tax or employment rights is a choice":

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8 *ITEPA 2003 Explanatory Notes*, March 2003 (Annex 2: Note 1) The text goes on to explain that "employment in the service of the Crown" is specifically included here "because it is not settled that all Crown servants have contracts of service."

9 Under the *Income Tax (Pay as You Earn) Regulations* SI 2003/2682

10 *Weightwatchers & Ors v HMRC* [2011] UKUT 433 (TCC) (14 October 2011) para 19

11 *Revenue Law: Principles and Practice*, 34th ed, 2016 para 8.22

> This perception is mainly held by individuals rather than businesses, but evidence[12] shows that some businesses will offer a choice of whether to contract as a self-employed worker with a tax free rate, as opposed to being offered employment. Equally, there are businesses that genuinely believe the arrangement is not an employment relationship and classify the individual as self-employed simply because the work is not permanent, but the classification of an individual's employment status does not rely on the permanency of the position.
>
> Employment status is not, however, a choice. It is a mixed question of fact and law that ultimately is for the courts to decide upon. In the absence of court action, however, businesses and individuals are expected to decide upon the 'correct' employment status themselves. This incurs time and cost, and is a continual process, because if the facts change, the status may change too. Businesses may consult their accountant or lawyer, which again increases the cost of the decision, but the penalties for getting the decision wrong are not just punitive, they can also affect the reputation of a business.[13]

In past cases the courts have shown themselves determined to look at a person's activities as a *whole*. In its commentary on this issue, *Tiley & Collison*, another standard legal text, cite comments made by Justice Lightman in a leading case on the question of determining employment status decided in 1996:

> There is no one test which is conclusive for determining into which category a particular engagement falls. There are a number of badges of one or other of the relationships and these badges depending on the context may carry greater or lesser weight. The proper course for the courts in each case … is to form an overall view giving due weight to the relative significance of the various badges in the particular context.[14]

Similarly as the Government has noted recently, "case law develops and the courts consider the relevant factors of each case … [but] despite there being some consistency across cases, there is no comprehensive code, tick list or formula to help an individual or employer to determine their status."[15] In their report the OTS provide an overview of case law in this area, underlining the point that although this has established certain tests for employment – specifically, to determine if a contract of service exists – this has not meant that interpreting the law is easy:

> Certain case law has stood the test of time. On such test that has been referred to time and time again is the MacKenna test in *Ready Mixed Concrete* … This case hails from the late 1960s and proposed the following test:[16]
>
> *"A contract of service exists if these three conditions are fulfilled.*

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12 Clark T (2014b) 'Unwilling freelancers give the lie to unemployment statistics', *Guardian*, 28 October 2014.

13 *Employment Status report*, March 2015 para 2.14-5

14 *Tiley & Collison UK Tax Guide* 2016/17 ed para 14.11 (citing *Barnett v Brabyn* [1996] STC 716 at 724c). The authors add, "while the best starting point is to ask whether the person is in business on his or her own account this may, on some facts, be little more than a way of reformulating the question. There is no infallible criterion and there can be many borderline cases" (para 14.14).

15 BEIS/HMT/HMRC, *Employment status consultation*, February 2018 para 5.3

16 MacKenna J in *Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance* [1968] 2 QB 497

> *(i) The servant agrees that, in consideration of a wage or other remuneration, he will provide his own work and skill in the performance of some service for his master.*
>
> *(ii) He agrees, expressly or impliedly, that in the performance of that service he will be subject to the other's control in a sufficient degree to make that other master.*
>
> *(iii) The other provisions of the contract are consistent with its being a contract of service."*
>
> This test, however, was to establish whether a contract of service exists, not whether someone is employed or self-employed … or, in fact, to define what constitutes a contract for services.[17]

A second case – *Market Investigations*[18] – provides an alternative test for employment status: namely, to consider whether the individual is 'in business on their own account' - though subsequently this test has been found to be insufficient.[19] The courts have also considered other factors in determining employment status – mutuality of obligation, control, substitution, intention, equipment – though, as underlined in an important judgement in 1994 – *Hall v Lorimer* – the factors that are relevant will depend on the facts of the case:

> As was pointed out so eloquently in *Hall v Lorimer*[20], "This is not a mechanical exercise of running through items on a check list to see whether they are present in, or absent from, a given situation… Not all details are of equal weight or importance in any given situation. The details may also vary in importance from one situation to another." …
>
> In *Lorimer* we were told that: "In order to decide whether a person carries on business on his own account it is necessary to consider many different aspects of that person's work activity. 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. The process involves painting a picture in each individual case."
>
> The last sentence sums up the feeling of several legal commentators who were interviewed by the OTS. They felt that as soon as one case establishes a legal point, it will be distinguished by the next tribunal on its facts, thereby providing no consistency or certainty other than on those individual facts.[21]

While tax law makes the binary distinction between employment and self-employment, employment status for the purposes of *employment law* additionally distinguishes 'workers' who have fewer rights than employees - a category often termed 'limb b' workers, as this distinction

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17 *Employment Status report*, March 2015 para 2.53, para 2.23-4
18 *Market Investigations Ltd v Minister of Social Security* [1969] 2 QB 173 Cooke J
19 "The question assumes that the answer is either 'no' and that the contract is one of employment or 'yes' and that the contract is one for services. This precludes there being a third type of contract, for example a contract *sui generis*." *op.cit.* para 2.29
20 *Hall (Inspector of Taxes) v Lorimer* [1994] ICR 218
21 *Employment Status report*, March 2015 para 2.32, 2.49-50. To illustrate the complexity of the issue the OTS cite *Stack v Ajar-Tec Ltd* [2015] EWCA Civ 4, a case that took five years and two visits to the Court of Appeal to be settled (para 2.17).

is drawn by s230(3)(b) of the *Employment Rights Act 1996*.[22] This third status is not recognised by tax law, and is not discussed in detail here. Employment status for the purposes of employment law, and the statutory protections that individuals may claim, has been central to the recent debate on the implications of the 'gig economy', and, as noted above, it is examined at length in another Library paper.[23] In June this year the Supreme Court issued its judgement in the 'Pimlico Plumbers' case, deciding that a subcontractor plumber was a 'worker' with regard to employment law, and thus entitled to some employment rights.[24]

1.2 'False' self-employment and the gig economy

Employers may seek to exploit the uncertainties over employment status to try to ensure that workers they have engaged are treated as self-employed, even if this contradicts the facts on the ground. The incentives for disguising employment are primarily financial – an opportunity to reduce the amount of tax and NICs paid on the income from any engagement.

In 2009 the Labour Government published a consultation paper on the incidence of 'false' self-employment in the construction industry, which discussed these incentives:

> 2.1 Where workers, in whichever business sector or industry, provide their services they do so for income tax and National Insurance (NICs) purposes either on a self-employed basis or an employed basis. In order to determine how a worker should be treated, a series of tests has been developed through case law. These include such considerations as who controls the work, who takes the financial risk and whether the worker is in business on his own account. These are applied to the facts and circumstances and the terms of the engagement in order to decide whether the worker should be treated as employed or self-employed.
>
> The Pay as You Earn (PAYE) and NICs legislation imposes an obligation on the person engaging the worker (the "engager") to determine the status of a worker by applying these tests. This obligation applies across all industries and sectors and includes engagements within the construction industry.
>
> 2.2 Engagers also have to ensure that from an employment law perspective the contract with the worker properly reflects the reality of the relationship.
>
> 2.3 False self-employment occurs where the underlying characteristics of the relationship are employment but the engagement is presented as self-employment. This is primarily

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22 For a summary description of the associated employment rights given to employees, and workers, see, BEIS/HMT/HMRC, *Employment status consultation*, February 2018 pp11-12 (Table 1). The paper notes that "at present, Limb (b) workers are usually taxed on a self-employed basis" (para 10.5).

23 *Employment status*, Commons Briefing paper CBP8045, 28 March 2018

24 [2018] UKSC 29, 13 June 2018. see, "Court rules plumber is a 'worker' in pivotal gig economy case", *Financial Times*, 13 June 2018 & "Passport to Pimlico", *Taxation*, 21 June 2018.

> driven by the differences in tax and NICs treatment of the self-employed and employed, which are as follows:
>
> - employer's NICs are due on payments to employees, but not on payments to those engaged on a self-employed basis;
> - the self-employed pay NICs at a lower rate than the employed; and
> - the self-employed are taxed on the profits of their business and the rules on what they can deduct from the gross income are more generous than those applied to employment income.
>
> 2.4 As a result of these differences, workers and engagers have a financial incentive to attempt to portray their employment income as income from self-employment in order to reduce their tax and NICs liabilities. However, there are also non-tax pressures which can influence the decision, such as the costs for employers of holiday pay and pension contributions.[25]

At the time it was estimated this revenue loss was about £350m pa.[26] HMRC did not update these estimates,[27] and the current Government has not provided an estimate for this cost:

> **Asked by Justin Madders** : To ask Mr Chancellor of the Exchequer, what estimate he has made of the cost to the public purse of lost revenue resulting from incorrect classification of individuals as self employed in each of the last three years.
>
> **Answered by: Mel Stride** : The government has not produced an estimate of the cost to the Exchequer of lost revenue as a result of false self-employment.
>
> The Chancellor, in a response to a question from the Shadow Chancellor during the Budget debate on 15 March 2017, said he recognised 'that there is a problem of bogus self-employment. There is a problem of employers who are refusing to employ people, requiring them to be "self-employed". There is a problem of individuals being advised by high street accountants that they can save tax by restructuring the way they work. We do believe that people should have choices, and we do believe that there should be a diversity of ways of working in the economy—we just do not believe that that should be driven by unfair tax advantages.'
>
> HM Revenue and Customs is aware that false self-employment presents a risk and is deploying compliance resources to address that risk. It will take appropriate action where false self-employment is identified.[28]

The Treasury paper argued that false self-employment also posed a serious threat to individual workers, and risked undermining the competitiveness of the industry as a whole:

> The problems that false self-employment causes can be summarised as follows:

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25 HM Treasury/HMRC, *False self-employment in construction: taxation of workers*, July 2009 p5
26 *op.cit.* para 3.5
27 HC Deb 12 November 2012 c5W
28 PQ934, 3 July 2017

- for the industry, an unfair competitive advantage for those businesses who disregard their Pay as You Earn (PAYE) and National Insurance (NICs) obligations when they engage workers and a corresponding disadvantage for those businesses which properly engage their workers as employees;
- for the worker, a loss of entitlement to Jobseekers Allowance and Secondary State Pension and a lack of long term job security and career opportunities; and a risk to the Exchequer, as the correct amount of income tax and NICs is not being paid.[29]

In its 2015 report on employment status the OTS discussed the available evidence on the scale of these costs:

> Using HMRC's published data, a starting position for the tax lost could be calculated as follows.
>
> The total number of tax-paying self-employed people in 2012/13 was 3,490,000 according to HMRC's personal income statistics. The same data gives the mean self-employment income as £21,000. The OTS has calculated that if self-employment income of £21,000 is re-categorised as employment income an additional £900 tax and NICs is payable.
>
> Taking these assumptions, it is possible to crudely estimate tax gaps for different scenarios of which percentage of the self-employed population should be re-categorised as employed.
>
> This is done by multiplying different percentages of the total self-employed population by the additional tax and NICs payable for the mean self-employment income, see Table 1.I:

Table 1.I: Calculation of tax gap for employment status, different scenarios

Estimated % of self-employed taxpayers who should be categorised as employed	10%	5%	3%	1%
Estimate of total tax/NICs underpaid	£314m	£517m	£94m	£31m

Source: OTS analysis of HMRC data

By way of comparison, the authors noted that in December 2013 the Coalition Government had consulted on measures to prevent employment intermediaries facilitating false self-employment, and that HMRC had estimated that this type of false self-employment "had resulted in 200,000 people in the construction sector and 50,000 others being wrongly designated as self-employed (though no longer, following legislation)."[30]

Historically HM Revenue & Customs' advice on determining employment status for tax indicated the points which had influenced the court's decision, based on a series of questions.[31] In May 2017 the Work and Pensions Committee published a report on self-employment and the gig economy, which discussed HMRC's approach:

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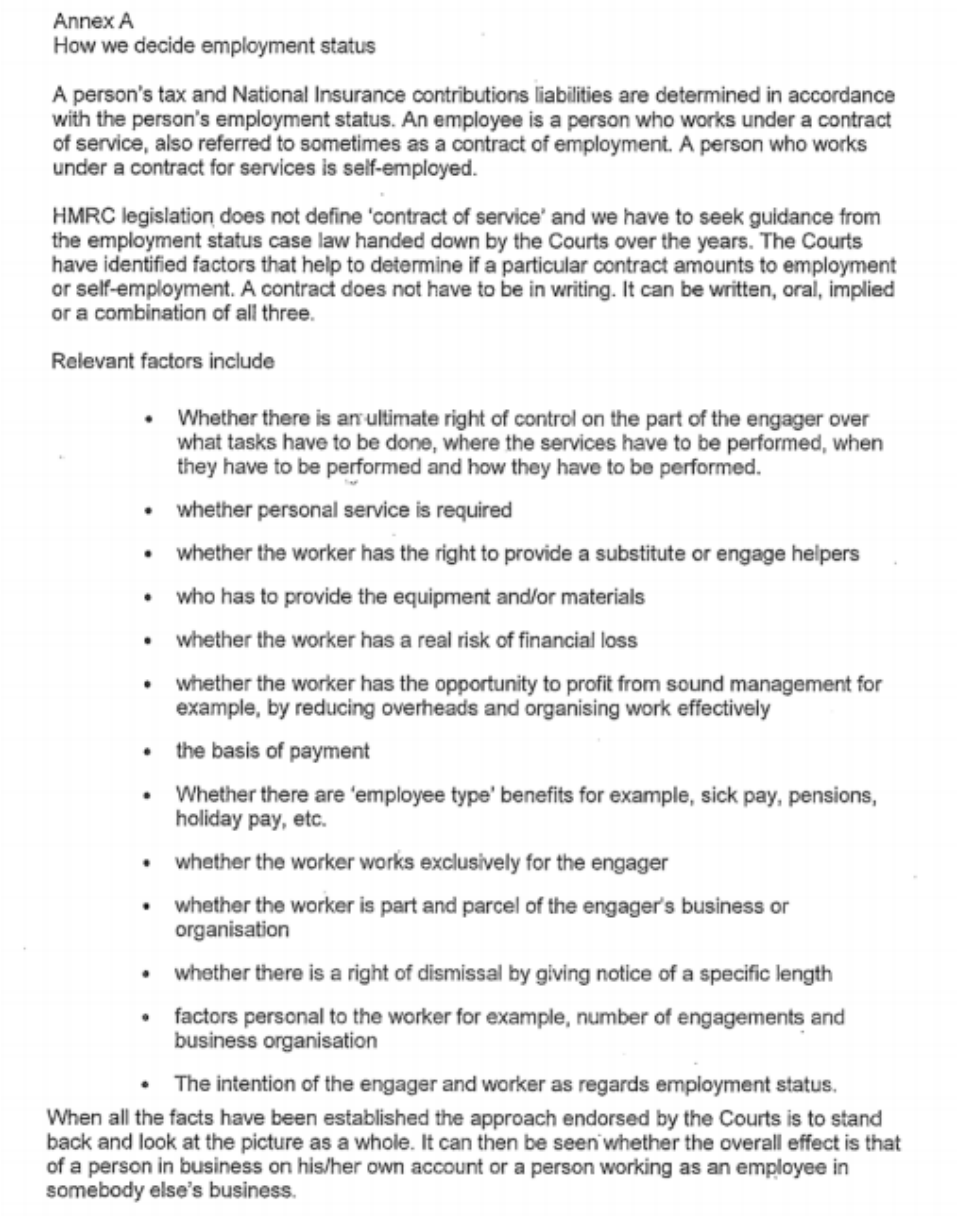
29 *False self-employment in construction: taxation of workers*, July 2009 para 3.1

30 *Employment Status report*, March 2015 para 1.37-40. The 2013 consultation is discussed in section 3 of this paper.

31 *Are your workers employed or self-employed for tax and National Insurance contributions ES/FS2*, August 2008. This note has been withdrawn, as HMRC now collate guidance in its online *Employment Status Manual*.



Annex A
How we decide employment status

A person's tax and National Insurance contributions liabilities are determined in accordance with the person's employment status. An employee is a person who works under a contract of service, also referred to sometimes as a contract of employment. A person who works under a contract for services is self-employed.

HMRC legislation does not define 'contract of service' and we have to seek guidance from the employment status case law handed down by the Courts over the years. The Courts have identified factors that help to determine if a particular contract amounts to employment or self-employment. A contract does not have to be in writing. It can be written, oral, implied or a combination of all three.

Relevant factors include

- Whether there is an ultimate right of control on the part of the engager over what tasks have to be done, where the services have to be performed, when they have to be performed and how they have to be performed.
- whether personal service is required
- whether the worker has the right to provide a substitute or engage helpers
- who has to provide the equipment and/or materials
- whether the worker has a real risk of financial loss
- whether the worker has the opportunity to profit from sound management for example, by reducing overheads and organising work effectively
- the basis of payment
- Whether there are 'employee type' benefits for example, sick pay, pensions, holiday pay, etc.
- whether the worker works exclusively for the engager
- whether the worker is part and parcel of the engager's business or organisation
- whether there is a right of dismissal by giving notice of a specific length
- factors personal to the worker for example, number of engagements and business organisation
- The intention of the engager and worker as regards employment status.

When all the facts have been established the approach endorsed by the Courts is to stand back and look at the picture as a whole. It can then be seen whether the overall effect is that of a person in business on his/her own account or a person working as an employee in somebody else's business.

The Committee noted that it had received evidence illustrating the efforts taken by companies involved in the gig economy made to demonstrate to HMRC that their workers were, in fact, self-employed:

> This hinged on showing that workers are denied anything that might afford them the status of employees. Dan Warne, of Deliveroo, told us that his company did not offer its workers certain benefits because this would jeopardise their self-employed status—and Deliveroo's existing business model. When pushed, however, Deliveroo, along with Amazon and Uber, conceded that their business models would still be viable if they took on couriers and drivers as employees. They might simply be less profitable.
>
> The contracts that we saw from several companies also explained in great detail why workers were not employed, and the benefits that they would not receive. Beyond this there seemed to be little that would constitute a substantive reason or case for taking on workers on a self-employed basis. Flexibility is not the preserve of

> the self-employed. Indeed, it is a growing feature of work on regular employment contracts.[32]

A tribunal case in January 2017 illustrates the difficulty of determining employment status, and the incentives for employers to craft the conditions on which they engage workers to ensure they may be classified as self-employed.[33] The case involved a partnership that provided haulage services to the construction industry, which claimed the drivers it engaged were not employees but independent contractors. The tribunal considered the various tests established by the relevant 'case-law, applying them to the facts, but found that, "not unusually, the indicia of employment vs self-employment, when applied to the facts of this case, do not point consistently in one direction":

> The facts that the drivers operated without supervision and had a limited right to substitute other drivers in their place, point to self-employment; the lack of evidence that the drivers were in business on their own account, combined with quite prescriptive rules for the performance of the deliveries imposed by the appellant, point to employment."[34]

It noted that the employer had taken legal advice on the way it should structure its relationship to its drivers, to ensure a finding of self-employment. Nevertheless the tribunal ruled that the drivers were, in fact, employees:

> The case authorities underline the importance of avoiding a checklist approach to these indicia of employment, and of making an informed, considered, qualitative appreciation of the whole picture.
>
> The picture here is of business-savvy appellant which entered into detailed written agreements to provide delivery services for its customers, which were larger commercial concerns, and built up a network of men to drive its lorries.
>
> The drivers were engaged on unwritten, short term contracts, on standard terms largely dictated by the appellant. Some drivers engaged with the appellant on just a handful of occasions – others did so over extended periods of time. The appellant, for its part, was clearly carrying on business on its own account, seeking to profit from the difference between what it was paid for deliveries by its customers, and the costs of the lorries and the drivers. The drivers, on the other hand, were, on the evidence before us, essentially "day labourers" engaged on terms that were unwritten, uncomplicated and non-negotiable. This was the manner in which the appellant chose to run its business and control its main cost (apart from the lorries themselves).
>
> Short term though the engagements were, it is our perception, stepping back and looking at the whole picture, that "master and servant" (whilst somewhat outdated phrases today) is an apt description of the relationship between the appellant and its drivers. Mr Dhillon, the managing partner of the appellant, was, in our perception, very much the "boss" in this relationship; and it is this, combined with the near-total absence of evidence that the drivers were running their own businesses, that leads us to decide

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32 *Self-employment and the gig economy*, 1 May 2017, HC 847 of 2016-17 para 18

33 *RS Dhillon and GP Dhillon Partnership v HMRC* [2017] UKFTT 17 (TC) (3 January 2017)

34 *op.cit.* para 87

> that the drivers were employees of the appellant rather than self-employed contractors.[35]

In a case report on the decision, *Practical Law* noted, "determining employment status is very topical":

> It is increasingly difficult to identify whether any individual is an employee or not, particularly in the current so-called "gig" economy. This decision, together with the recent decision in *Mitchell* in particular, suggests that the traditional indicia of employment may be increasingly inconclusive in determining status.[36]

Finally, in November 2017 HMRC published some research the 'sharing economy' and its participants. It found that while "around 11 per cent of the working age population (or roughly 5.3 million individuals) in Great Britain" were involved as providers in this sector, "many providers exhibited low confidence and a lack of understanding about the tax system and their obligations":

> **The scale and profile of the Sharing Economy**
>
> The findings estimate that around 11 per cent of the working age population (or roughly 5.3 million individuals) in Great Britain take part in the Sharing Economy as providers. As discussed in the introduction, this population estimate is based on a specific definition of the Sharing Economy.[37]
>
> As there is no widely agreed definition of the Sharing Economy, the estimates given in this research may not be comparable to estimates given in other pieces of research ... The estimated total value of gross income generated by providers in the Sharing Economy is around £8bn annually while the annual mean income providers earn through the Sharing Economy is approximately £1,700. These estimates must be considered in the context of the design of the survey questions for this research, which pose some limitations.[38]
>
> **Tax-related behaviour of Sharing Economy providers**
>
> Many providers exhibited low confidence and a lack of understanding about the tax system and their obligations in relation to the Sharing Economy. A quarter of all providers said they knew very little or nothing at all about how their Sharing Economy income is taxed. Qualitative evidence suggests that providers who were new to both the Sharing Economy and to being self-employed in particular tended to have a limited understanding of their tax obligations and the reporting process.
>
> On the whole the evidence indicates that providers seek to comply with their tax requirements. …
>
> A number of misconceptions also appear to be leading providers not to report their Sharing Economy income to HMRC. In some cases, providers believed that Sharing Economy activities were not

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35 *op.cit.* paras 88-9

36 "First-tier Tribunal holds that haulage drivers are employees", *Practical Law Tax*, 11 January 2017. The other case cited is, *Mitchell & Another v HMRC* [2011] UKFTT 172 (TC) (15 March 2011)

37 Defined in this research as economic activity facilitated by the internet, through digital platforms and applications (apps) that enable people or businesses to share, sell, or rent property, resources, or skills. The Sharing Economy functions by matching suppliers and customers through common platforms.

38 See chapter 3.1 for full details on the limitations.

> subject to tax at all, because their earnings were too sporadic or small, or their Sharing Economy activity was part of a hobby. Another misconception was that Sharing Economy activities were separate financially from other activities, and so had their own Personal Allowance. This meant providers felt they did not have to pay tax on their Sharing Economy income, as it was less than the Personal Allowance, despite other income sources already putting their overall income over the Personal Allowance threshold.[39]

The Low Incomes Tax Reform Group has recently published guidance for those involved in the gig economy.[40] In a press notice, Chair of LITRG Anne Fairpo suggested that the findings of this research "although worrying" were not surprising:

> Given the irregular and often 'on demand' nature of 'gig economy' income, in many cases it does not even occur to many people that their income is taxable, let alone what their obligations are in respect of it.
>
> This is down to an overall lack of tax antennae and the fact that HMRC do not really provide those in the 'gig economy' with any tailored information that they can use and apply to their own situation. Indeed, the GOV.UK page on selling services online currently gives the impression that it is only necessary to file a tax return if one needs to pay income tax, i.e. if total income is more than the personal allowance and any other reliefs for which one is eligible.
>
> In fact, anyone who is self-employed with income above the £1,000 trading allowance needs to complete a tax return and is obliged to tell HMRC so that a self-assessment record can be set up. Anyone who relies on this GOV.UK page and neglects to complete a tax return risks being unintentionally non-compliant.[41]

1.3 Reviewing employment status in the late 1990s

Exactly the same rules for determining whether one is employed or self-employed for tax apply to the construction industry as to all other industries. However companies and individuals working in this sector have often encountered particular difficulties in settling this question, as labour-only subcontractors are often short term or casual workers.

In October 1995 the tax authorities published new guidance following representation from the industry that establishing employment status was proving particularly difficult.[42] This resulted in many construction contractors reviewing the employment status of the workers they had taken on. In addition many believed – if mistakenly – that this measure represented a change in the law, which would result in all

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39 HMRC, *Sharing Economy: User characteristics and tax reporting behaviour: HMRC Research Report 453*, November 2017 pp70-1

40 LITRG, *Tax if you work in the gig economy*, September 2018

41 LITRG press notice, *October 5 deadline warning among advice in urgently needed 'gig economy' factsheet*, 4 September 2018

42 *Are Your Workers Employed or Self-Employed? IR148*, October 1995. The leaflet was withdrawn some years ago; archive copies were deposited in the Library in answer to a PQ about employment status in 2012 (HC Deb 17 January 2012 c770W; Commons Dep 2012-0395, 17/1/2012).

subcontractors being taxed as employees rather than self-employed persons.

The new guidance stated that "people are self-employed if they are in business on their own account and bear the responsibility for its success or failure", and went on to give a number of pointers which indicate if this was the case or not in any particular job of work:

- the degree of direction or control a contractor had over the worker;
- whether the worker supplied any expensive or heavy equipment to do this work;
- the degree of financial risk faced by the worker in taking on the job;
- whether the worker could hire and pay someone else to do this work; and,
- the length of time the contract was for.

Even though the length of the worker's engagement was only one of these pointers, there was considerable concern that a contract for a given amount of time, say three months, would necessarily qualify as employment. The new guidance was at pains to emphasize this was not the case:

> The **length of engagement** may be a factor, but will not be decisive. You must consider the terms of the engagement even where a worker is engaged for only a day. Long periods working for one contractor may be typical of an **employment**, but even a very short-term engagement could amount to **employment**.[43]

Construction firms remained concerned about when they might have to complete any review of their workers' employment status, and if they had sufficient information to explain any necessary changes to their workforce. In addition the industry sought an assurance that, by a given date, all construction firms would have had to have made any necessary changes in employment status and be deducting PAYE and NICs so that there might be a level playing field when firms competed for contracts.

In November 1996 the Inland Revenue and the Contributions Agency[44] announced a number of initiatives to help the industry review the employment status of their workers; details were given in a press notice at the time:

> **a.** Contractors will be given a reasonable time in which to review the employment status of their workers and set up PAYE arrangements where these are necessary but all contractors will be expected to have completed their reviews by 5 April 1997 at the latest and, where appropriate, to be accounting for PAYE and NICs by that date.

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[43] *Inland Revenue leaflet IR148*, October 1995 p4. The wording was unchanged in an updated version of *IR148* (March 2001 p5).

[44] The Agency – at the time an executive agency of the Department for Social Security, and responsible for collecting and recording NICs – was merged into the Inland Revenue in April 1999. In April 2005 the Inland Revenue was merged with HM Customs & Excise to form HM Revenue & Customs.

> **b.** Where, after that date, contractors are found not to be accounting for PAYE and NICs in respect of payments to employees, the Inland Revenue and Contributions Agency will normally seek payment of arrears back to 5 April 1997. Payment will be sought for earlier years only where there has been clear evidence of evasion.
>
> **c.** The present level of compliance visits to review contractors' records will be maintained in order to help them with employment status issues and ensure arrangements are being made to operate PAYE and NICs.
>
> **d.** From 2 December 1996, the following telephone Helpline will be available for contractors and workers who need general assistance with employment status queries. Tel Helpline: 0345 733 55 88.
>
> **e.** A leaflet will shortly be published by the Inland Revenue,[45] to help construction workers understand how a change of employment status may affect their tax and national insurance liabilities. The leaflet will also provide guidance on self assessment.[46]

Further guidance for contractors was published in April 1997, which included a number of worked examples on how employers should decide employment status.[47]

In December 1998 the Government gave some figures on the numbers of workers reclassified as employees as a consequence of this new guidance:

> **Dr. Cable:** To ask the Chancellor of the Exchequer what is (a) the estimated annual revenue charge and (b) the number of firms and employees involved in the change from self-employed sub-contractor status to PAYE status in the construction industry.
>
> **Ms Hewitt:** The Inland Revenue estimates that in excess of 200,000 workers in the construction industry have been reclassified from self-employed to employed status since April 1997. This has happened for a number of different reasons. Many contractors have carried out their own status reviews and concluded that some or all of their workers should be properly treated as employees.
>
> Alternatively, workers may have been reclassified as employees following an IR or CA compliance visit. No estimate is available of the number of firms involved. Because of the many differences in how the earnings of self-employed and employed workers are treated for tax and National Insurance purposes, it is not possible to provide an estimate of the annual revenue charge involved.[48]

In November 2000 Jonathan Shaw MP raised concerns about workers being incorrectly classified in a debate in Westminster Hall; part of his speech is reproduced below:

> Subcontractors will tell a building operative that work is available only for the self-employed--who have no rights and to whom

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45 This guidance – *Workers in building and construction IR157* – was published in January 1997, though it was subsequently withdrawn.

46 Inland Revenue press notice, *Inland Revenue and Contributions Agency provide more help for the construction industry on employment status*, 19 November 1996

47 "Workers in the construction industry", *Tax Bulletin*, issue 28 April 1997 pp 405-413

48 HC Deb 7 December 1998 c29W

> immediate notice can be given. However, in practice, such workers are controlled and directed, required to turn up at a site at a given time, instructed to take training, have to clock on, and may not seek to be replaced during the period of work. To all intents and purposes, therefore, they are workers and do not enjoy the flexibility of self-employed individuals …
>
> Trade unions have successfully brought cases to employment tribunals, yet the practice continues. Even where workers are employed, disregard for the working time directive is commonplace, because people cannot afford to lose their jobs. They can go to an employment tribunal to demand holiday pay--and can, in the main, expect to win--but that takes time and puts individuals' livelihood at risk. If an individual has a family to support, he simply will not take that risk. The question is whether someone in such circumstances, who has been denied basic employment rights, will feel secure enough to challenge dangerous working practices.[49]

In responding to the debate the then Parliamentary Under-Secretary of State for the Environment, Transport and the Regions, Beverley Hughes, acknowledged these concerns about the sector's safety record, but suggested that this should not be simply attributed to the way individuals were being classified as self-employed, and that there was now a trend toward contractors taking individuals on as employees:

> At the outset I make it clear that the construction industry deals with a complex set of circumstances, all of which impact on working conditions. The excessive number of hours worked and some of the other employment issues to which my hon. Friend referred are important factors, but we must discuss those in the context of the industry's poor record on all areas of employment, including training, health and safety and site conditions. The industry's culture and attitude is often adversarial and aggressive, and for too long it has paid too little attention to the position of workers and the conditions in which they work …
>
> Some contractors are moving in the direction of employment. Over the past four years since 1996, the proportion of people working in the industry was initially broadly balanced between self-employed and employed, but the trend is now shifting. Now the proportion of employed to self-employed is almost double.[50]

One related issue to employment status for businesses and individuals in the construction industry is the operation of the 'construction industry tax deduction scheme', or CIS for short. The scheme, which was introduced in 1971, requires contractors to make a fixed deduction from payments made to self-employed subcontractors, to be set against the subcontractor's liability to tax and NICs.

In certain circumstances, subcontractors *may* be entitled to receive payment gross. Legislation to reform the scheme was introduced as part of the *Finance Act 2004*, and the new scheme was launched in April 2007. One part of the scheme is that contractors must make a

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49 HC Deb 28 November 2000 cc189WH-190WH
50 *op.cit.* cc193WH-194WH

formal declaration that anyone they pay under the scheme is, indeed, self-employed.[51]

In 2004 the Labour Government announced that it would consider an industry proposal to reduce uncertainty in the verification process: to classify all labour-only subcontractors as employees for tax purposes.[52] However, this idea was not pursued. The 2005 Budget report noted the Government were "presently discussing with the industry a range of practical options to help clarify this dividing line, and so reduce tax avoidance and resolve any employment rights issues."[53]

In January 2006 HM Revenue & Customs launched an online service – Check Employment Status for Tax ('CEST') – to help businesses and individuals determine the employment status of any contract.[54] The introduction of CEST was not without its critics, as practitioners suggested that any type of checklist would be a blunt instrument.[55]

In 2017 HMRC updated this online tool, to help freelancers and their clients determine if engagements fall within the scope of the 'intermediaries rules'. This tax avoidance legislation, often referred to as 'IR35', seeks to prevent freelancers avoiding the tax implications of being classified as an employee by providing their labour services to clients through an intermediary – such as a personal service company.[56] On their site HMRC state that they will stand by the result given by the online tool, unless a compliance check finds the information provided is not accurate, but it will not accept cases where the results have been achieved "through contrived arrangements designed to get a particular outcome from the service."[57]

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51 For further details see, *Taxation in the construction industry*, Commons Briefing Paper CBP814, 9 June 2017. Detailed guidance on the scheme is on Gov.uk.

52 Inland Revenue press notice 16/04, 23 March 2004

53 *Budget 2005*, HC 375, March 2005 para 5.120

54 HMRC press notice NAT 06/06, 30 January 2006

55 eg, "Dinosaur of tax?" & "A blunt tool?", *Tax Journal*, 29 September 2008 & 14 May 2007. *Tiley & Collison* comment that the online service "is not a highly sophisticated tool, but considers the basic indicators and gives an opinion" (*Tiley & Collison UK Tax Guide* 2016/17 ed para 14.14 fn13).

56 The development of IR35 and its application in the public sector, including the updated CEST, is discussed at length in, *Personal service companies & IR35*, Commons Briefing paper CBP5976, 6 September 2018.

57 The online service is available on Gov.uk.

2. The Labour Government's consultation in 2009

2.1 Assessing the scale of the problem

In May 2008 the Union of Construction, Allied Trades & Technicians (UCATT) published a report it had commissioned from Professor Mark Harvey, at the University of Essex. The author suggested that around 30% of the workforce – 375,000 to 425,000 - were inaccurately engaged as self-employed, a trend in part explained by the growth in migrant labour coming to the UK.[58]

Professor Harvey's estimate came from comparing the proportion of the workforce that was self-employed in the UK with other industrialised countries, supported by survey evidence from UCATT of a small selection of construction sites, showing that at over half of these sites, over half of those on-site were 'self-employed'.

Based on these estimates, Professor Harvey estimated that this form of tax evasion cost the Exchequer around £1.7bn a year. The work was cited in an Early Day Motion put down by Alan Meale MP, which called on the Government to "act immediately to end such practices both in the interests of the economy and more importantly for those who are forced or encouraged into such employment scenarios by unscrupulous employers whose intent is merely to make a fast buck, whatever the consequences for those they employ."[59]

Official estimates of the amount of false self-employment published at this time were much lower, though still significant:

> **Mr. Hepburn:** To ask the Chancellor of the Exchequer (1) what estimate he has made of the number of construction workers who are bogus self-employed; (2) what estimate he has made of the national insurance and tax revenue foregone to the Treasury as a result of bogus self-employment in the construction industry in each of the last five financial years.
>
> **Angela Eagle:** HM Revenue and Customs believes that there could be up to 200,000 workers in the construction industry who are incorrectly being treated by their engagers as self-employed. We estimate that the consequent Exchequer loss currently is around £350 million per annum.
>
> No estimates of the Exchequer loss for earlier years have been made. Information from the Office for National Statistics[1] for the fourth quarter of 2007 estimates that there are around 1,450,000 employees and around 850,000 self-employed working in the construction industry. The Department for Business, Enterprise and Regulatory Reform, collects no specific data on workers within the construction industry.
>
> [1]From the Labour Force Survey[60]

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58 M.Harvey & F.Behling, *The evasion economy: false self-employment in the UK construction industry*, UCATT May 2008

59 EDM 2099 of 2007-08, 21 July 2008. 38 Members signed this motion.

60 HC Deb 21 April 2008 c1686W

2.2 The consultation paper

As noted, in July 2009 the Labour Government published proposals to tackle the problem of false self-employment in the construction industry. The consultation paper explained why the tax authorities were finding it difficult to prevent this happening:

> It is a relatively simple matter to present an engagement as self-employment. In many instances there is no written contract setting out the terms of the engagement; the engagement is simply labelled as one of self-employment.
>
> In addition, there are specialist advisory firms who provide contracts which, they claim, contain all that is needed to be classed as self-employed. This is usually achieved simply by incorporating a number of employment case law factors, particularly the right of substitution. In many cases, these contract terms bear little resemblance to the actual conduct of the work or the conditions under which it is carried out.
>
> Where both the worker and the engager decide that self-employed status is the desired outcome, then it is very challenging for HMRC to build a full and accurate picture of the true terms of the engagement. As a result, demonstrating any mismatch between the contract and the reality can be difficult and time-consuming. Or, if there is no written contract in place, establishing the actual terms of the engagement can also be problematic.[61]

The paper went on to suggest that earlier official estimates of the scale of the problem had most probably been too low:

> Within all industries and sectors it is the case that certain services will be provided on a self-employed basis and this is no different in the construction industry. However, within this industry there is a much higher proportion of self-employed workers than in other sectors. The results from the European Labour Force Survey 2007 showed that 34 per cent of workers in the construction industry are self-employed, compared to only 11 per cent across other sectors. Even given the range and variety of skills used by the industry, there is no obvious reason why the proportion of self-employed workers in the construction industry should be so high.
>
> In addition, both HM Revenue and Customs' (HMRC) compliance activity and statistical evidence points towards there being a substantial number of workers in the industry, working under employment terms but being presented as self-employed. Given the nature of construction work, the supply of materials, plant or equipment is key to the completion of any contract.
>
> In 2007/08, the Government estimates that there were 300,000 subcontractors operating within [CIS] who did not claim any deduction for the costs of materials, nor for plant and equipment. These subcontractors provided none of the materials or plant and equipment which would form a substantial element of any contract and provided only their labour. The Government believes that a large proportion of these subcontractors, who represent approximately one third of the active subcontractor population, and are operating as sole traders, will in fact be working under employment terms. Furthermore, HMRC compliance activity has shown that in practice these engagements will also display other

[61] *False self-employment in construction: taxation of workers,* July 2009 paras 2.9-2.10

> features which are closer to employment. These include a large measure of supervision and control by the engager, a lack of financial risk, an obligation for personal service, and lengthy periods with the same engager.[62]

The trend toward workers being presented as self-employed had also been encouraged by the actions of intermediaries: employment agencies placing construction workers with contractors, often through an 'umbrella' company, to ensure that the worker could be classified as self-employed.[63]

The Government argued that the sheer scale of false self-employment in the construction industry called for a new statutory test to apply to just this sector of the economy:

> The Government proposes that, where a person, ("the engager") whose main business involves the carrying out or commissioning of "construction operations" (as defined for the purposes of the Construction Industry Scheme, CIS[64]), uses the services of a worker to carry out such operations, then the payment received in respect of those services will be deemed to be employment income. This deeming will occur unless the worker fulfils one of three statutory criteria. Any payment made to the worker which is deemed to be employment income will be subject to Pay as You Earn (PAYE) and NICs.[65]

These three criteria would be as follows:

> 1. Provision of plant and equipment – that a person provides the plant and equipment required for the job they have been engaged to carry out. This will exclude the tools of the trade which it is normal and traditional in the industry for individuals to provide for themselves to do their job;
>
> 2. Provision of all materials – that a person provides all materials required to complete a job; or
>
> 3. Provision of other workers – that a person provides other workers to carry out operations under the contract and is responsible for paying them.
>
> A worker will have to meet one or more of these three criteria in order not to be deemed to be in receipt of employment income.[66]

The paper suggested the new deeming provision was "intended only to apply to those workers who would in any case be considered to be employees if the existing case law tests had been properly and diligently applied." It went on to note "this measure will only deem a worker to be in receipt of employment income for the purposes of income tax and NICs and will not confer employment law rights on a worker."[67] One commentator raised this as a concern:

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62 *op.cit.* paras 2.5-2.7

63 This corporate form has allowed workers to provide their labour services to contractors, while remaining the employee of the umbrella company. The company pays the worker under PAYE, while the worker makes extensive use of travel, subsistence and other tax reliefs so as to minimise their taxable income.

64 Under s74 of the Finance Act 2004

65 *op.cit.* para 5.4

66 *op.cit.* paras 5.11-.12

67 *op.cit.* paras 6.2, 1.6

> It seems to be suggested (but not explicitly stated) that where workers are subject to this new regime they will obtain access to the same state benefits regarding a Class 1 National Insurance contribution history as 'genuine' employees. They will not, however, obtain any 'employment law rights'. Whether benefits such as statutory maternity pay and statutory sick pay are seen as 'employment law rights' or benefits will presumably be made clear in due course.[68]

The paper argued that the proposals would not prevent those who are "genuinely self-employed" from working this way: rather, this reform would "restore a level playing field for those businesses that are complying fully with their responsibilities. They will no longer be undercut by those who, up until now, have not chosen to comply."[69]

2.3 Responses to the consultation

These proposals attracted a lot of criticism, particularly from the tax profession. Writing in the technical journal *Taxation*, the then editor Mike Truman, took issue with the proposed new test for self-employment, suggesting that, "just because all those meeting at least one of the three criteria [set out in the paper] would be self-employed does not mean that all the self-employed will meet at least one of the criteria." A longer extract from his analysis is reproduced below:

> Dogs are mortal. Socrates is not a dog. Therefore Socrates is immortal? Clearly not. This is known as the fallacy of the 'undistributed middle'; the first statement does not say anything about all mortals, only about the canine subset of them. So what about this one? The presence of any of three criteria would mean that the courts would hold someone to be self-employed. This worker does not meet any of these three criteria. Therefore this worker is not self-employed. It is equally an example of the 'undistributed middle'; just because all those meeting at least one of the criteria would be self-employed does not mean that all the self-employed will meet at least one of the criteria. And yet that is the basis of the HMRC consultation paper …
>
> The proposal is that all those who cannot meet at least one of three criteria when working for an engager whose main business is the commissioning of construction operations should be deemed to be receiving employment income, and should be taxed on that basis by the payer (regardless of whether the payer and the engager are the same person).
>
> The three criteria are:
>
> - Provision of plant and equipment: that a person provides the plant and equipment required for the job they have been engaged to carry out. This will exclude the tools of the trade which it is normal and traditional in the industry for individuals to provide for themselves to do their job.
> - Provision of all materials: that a person provides all materials required to complete a job.

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68 "True or false", *Taxation*, 13 August 2009

69 *False self-employment in construction: taxation of workers*, July 2009 para 6.7

- Provision of other workers: that a person provides other workers to carry out operations under the contract and is responsible for paying them.

> These criteria are prefaced with the assertion that: *'The purpose of the legislation is not to deem a worker's income to be employment income where it is clear that the worker is carrying on a business and would otherwise be treated as self-employed.'*
>
> The logical fallacy of this is set out in my first paragraph, and I think it is highly unlikely that there wasn't at least one person with enough exposure to classical logic in the Treasury and HMRC team concerned who realised this. Yet the only admission that there could be any sort of a problem with the deduction made is in question 3 for feedback, which reads: *'Are there instances where none of the criteria are met, but a worker would, by reference to the usual case law tests in respect of the true terms of an engagement, otherwise be treated as self-employed? If so, please provide examples.'* [70]

The Chartered Institute of Taxation raised concerns that the new test would not affect the rights of workers with regard to employment law: "the proposed new procedures will catch many whom the Courts have held to be self-employed and do so only for tax purposes, whilst failing to address the issue of employment rights."[71] An extract from the Institute's submission is reproduced below:

> We are concerned that this consultation is only about 'how and when' legislation is to be introduced. It does not seem to address or analyse the underlying reasons for the perceived problem and possible ways of countering this. Nor does it have proper regard to the wider issues: only tax seems to be considered in an area that cries out for a review that takes into account tax, employee rights and benefits, employment law and business practice … These proposals merely try to cure one of the symptoms …
>
> We think it is important to consider what is meant by 'false self-employment'. The use of the term 'false' has the connotation of deliberate falsification involving evasion of tax and NIC and in this context the CIOT is very clear that HMRC should apply the toughest sanctions to those who may be involved. We have always taken this view and indeed would be concerned if HMRC have not been adopting this approach in recent years.
>
> On the other hand if there is an open – and fundamentally successful – construction of a contract for services where employment might have been a contemplatable alternative arrangement that is an entirely different matter. Where HMRC see an arrangement that is valid but that they do not like, they are of course at liberty to challenge it technically but should not describe it as 'false'.
>
> Recent case law suggests that HMRC may not have quite the same view on what constitutes employment and self-employment as the courts. We refer below to the cases of *Lewis (t/a MAL Scaffolding) v R&C Commrs* (2006) Sp C 527 and *Castle Construction (Chesterfield) Ltd v HMRC* (2009) UK SpC 00723 in this respect. These are not discussed in the consultative document but if HMRC would continue to regard the type of workers in

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70 "The undistributed middle", *Taxation*, 10 September 2009

71 Chartered Institute of Taxation press notice, *CIOT urge Government to rethink proposals to subject building contractors to PAYE deductions*, 27 October 2009

> those cases as 'employed' then we think the title of the consultative document is misleading because what is considered "false self-employment" by HMRC has been held to be genuine and proper self-employment by the courts.[72]

Similarly the Institute of Chartered Accountants argued that the solution to the problem of false self-employment "should be to refocus on compliance and helping employers and workers to adopt the correct tax treatment. Unfortunately, the solution proposed is not one of compliance … [the new test] redefines the dividing line and will make many workers who were correctly treated as self-employed into employees for tax purposes only":

> If the intention is to tackle genuinely false self-employment, we do not think that case law can be replaced by three simple tests in statute. The proposals appear:
>
> - to wholly ignore case law on employment, and
> - to adopt an unrealistic assumption that, instead of looking at the overall position, one can somehow determine the existence of an employment by the existence or absence of a very small number of features.
>
> The proposals will result in numerous cases of workers who were previously rightly classed as self-employed being reclassified as employees. The proposals will increase both the administrative burden of the tax system, and, the cost of construction, which we believe will be disproportionate to the particular problem that has been identified.
>
> The proposals would create a state of limbo for many vulnerable workers who would be taxed as employees without any of the legal protections that such status would bring. If they are taxed as employees, they will think that they are employees.[73]

Finally, the Low Incomes Tax Reform Group (LITRG) argued that the proposals would hit "the low-paid unrepresented worker":

> In the consultative document … HMRC want to tax all workers in the construction industry as employees 'unless one of three simple, clear and easy to apply criteria' is met. We think that there are many things wrong with that approach:
>
> *It is an over-simplification.* The tests evolved by the courts over the years to distinguish employment from self-employment income for tax purposes are by no means simple, but they do aim to reflect the true nature of each engagement. To add, as the Government seeks to do, a new artificial test for one ill-defined group of workers to the complexity of the existing rules will complicate the whole system yet further.
>
> *It is as much a fiction as false self-employment.* The abusers seek to escape tax and NICs by pretending that workers who are in reality employees are self-employed. HMRC seeks to counter that by pretending that all workers are employees, whatever their true legal status. One fiction replaces another, both equally at odds with reality.

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[72] Chartered Institute of Taxation, *False self-employment in construction: taxation of workers: CIOT comments*, 12 October 2009 paras 2.1, 2.4-2.6

[73] ICAEW (Tax Faculty), *False self-employment in construction: taxation of workers TAXREP 54/09*, 12 October 2009 paras 11-12, 5-8

> *It ignores the rights of low-paid workers.* By deeming workers who are in reality self-employed to be employed, it will deprive them of the tax advantages of self-employment, but it will not give them the legal rights (employment protection, statutory payments, and so forth) that genuinely employed workers have. A lose-lose situation for the low-paid.
>
> *If things go wrong, the low-paid worker risks having to pay the tax that the contractor ought to have paid, but did not.* This could involve a retrospective tax bill going back several years.
>
> *And it just makes the tax system more complex.* As if we didn't have enough complexity already.[74]

Other critics of the proposals included the Home Builders Federation and the Federation of Master Builders, who launched a campaign, 'Stop the Unfair Building Tax', arguing that it was unfair to treat the sector differently, and, if enacted, the proposals would discourage investment and growth.[75] UCATT, the construction union, did not publish a formal response, though the *Financial Times* reported that they had given the proposals a "cautious welcome."[76]

In December 2009, the Labour Government confirmed that it would publish a summary of the responses it had received "in the New Year", and would "continue to work with stakeholders to develop a legislative solution that is well targeted, effective and that allows the industry to retain a flexible labour supply."[77]

HM Treasury published this summary of responses in March, just prior to the 2010 Budget. In this the department noted that there had been "no consensus among stakeholders as to the tests that should be included within a legislative solution or that there should be a legislative solution of this nature." While most respondents agreed that there was false self-employment in the sector, only "some" thought it was a long-standing problem, and "the overwhelming view was that the proposals would not achieve the aims set down in the consultation":

> The main concern voiced by respondents was that the issue of employment status was too complicated to be resolved by only three criteria. Respondents also expressed concern about the practical application of the criteria. Some respondents suggested modifications to the criteria proposed in the consultation and some respondents suggested alternative criteria … A large number of respondents wished to retain the status quo. Many referred to current case law tests and a significant number suggested increasing HMRC compliance activity and ensuring that the rules are more rigorously applied. Some considered that the Construction Industry Scheme (CIS) was working well and more vigorous enforcement of these rules could address the problem.

Another major concern was the question of timing:

> Most respondents who commented on timing agreed that, given the current economic outlook, it would not be appropriate for the deeming test to be introduced in the very near future. Many

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74 LITRG press notice, *HMRC tackles the 'lump' again - but who loses?*, 30 October 2009

75 "Building industry unites to fight tax crackdown", *Times*, 4 December 2009. At the time the two organisations set up a website for their campaign.

76 "Builders give tax proposals a hammering", *Financial Times*, 3 November 2009

77 *Pre-Budget Report*, Cm 7747, December 2009 para 5.95

> believed that there should be a lead in time before the measure becomes effective to allow businesses to plan.[78]

For its part the Government took the view that a new deeming test was a feasible goal:

> The Government is committed to tackling this issue … continuing with the status quo or legislating the current case law tests are not viable options. One of the purposes of having a deeming test is to make the process of determining whether a worker is truly self-employed more straightforward. In devising a test, it is necessary to balance complexity with achieving a test which is practical, effective and achieves the correct answer.[79]

However, no further announcements were made by the Labour Government. The Budget report, published later that month, simply noted, "the Government is committed to addressing this problem and will continue to work with stakeholders to develop a legislative solution."[80]

78 *False self-employment in construction: taxation of workers - summary of consultation responses*, 9 March 2010 para 1.5, para 4.2, paras 4.13-4.16
79 *op.cit.* para 4.19
80 *Budget 2010*, HC 451, March 2010 para 5.94

3. Disguised self-employment : the Coalition Government's reforms

Following the inconclusive outcome to the Labour Government's review, the issue of false self-employment was not mentioned in the new Coalition Government's first Budget in June 2010.

However, the issue re-emerged subsequently in the 2010-15 Parliament, in connection with concerns about the activities of 'intermediaries' facilitating tax avoidance – a practice first seen in the construction industry, but spreading to other sectors. Broadly speaking an intermediary is an entity which interposes itself between a worker and the engager – such as an employment business or agency, or a personal service company (PSC), a small limited company thorough which an owner/director provides their own labour services to their clients.[81]

At the time of the 2013 Budget the Government confirmed that it would consult on measures to tackle tax avoidance by intermediaries, based offshore, who provided labour services to UK companies. A review of these arrangements had found that at least 100,000 individuals were employed through an intermediary company that had no presence, residence or place of business in the UK. In many cases employees were unaware that their payroll was located offshore and tax was being avoided on their earnings.[82] In October 2013 the Government announced changes to both income tax and National Insurance rules to tackle the problem, as well as a special certification scheme for the oil and gas sector.[83]

Legislation to make this series of changes was split three ways: first, the *Finance Act 2014* included provisions for the necessary changes to income tax, and the new requirements regarding record-keeping and returns; second, changes to NICs were made by secondary legislation; third, provision for the certification scheme for the oil and gas sector was included in the *National Insurance Contributions Act 2014*.[84] In the latter case, the main purpose of this legislation was to introduce a new 'Employment Allowance' – a £2,000 cut in employer NICs for all businesses and charities – from April 2014.[85]

In December 2013 the Government published a second consultation, on proposals to prevent intermediaries based in the UK labelling workers as self-employed, by means of contrived contractural terms, so as to avoid

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81 As noted above, the exploitation of this corporate form for tax avoidance is a separate, if related issue. An introduction to this issue is given in House of Lords, *Personal Service Companies*, HL Paper 160, 7 April 2014.

82 HC Deb 18 March 2013 c34WS

83 *Offshore employer intermediaries – summary of responses*, October 2013

84 For more details see the Parliament Bill page. The background to the Bill is examined in Library Research paper RP13/60, 20 November 2013; its scrutiny in the House is discussed in Library standard note SN6761, 26 February 2014.

85 Guidance on the Employment Allowance is on the Gov.uk site. The Allowance was increased to £3,000 from April 2016.

tax and NICs.[86] In the past this had been a problem in the construction industry but the evidence showed that the practice was becoming more widespread:

> The use of intermediaries to facilitate false self-employment started in the construction industry as a way to reduce the risk to engagers of incorrectly engaging workers on a self-employed basis. However, this type of avoidance facilitated through intermediaries is now widespread in a number of other sectors including driving, catering and the security industry. In those other sectors, there is evidence of existing permanent employees being taken out of direct employment and being moved into false self-employment arrangements involving intermediaries. These intermediaries often require the worker to pay a fee of between £10 and £25 per week, further reducing any benefit to the worker of these arrangements.
>
> There are a number of ways which intermediaries are exploiting the legislation to facilitate the avoidance of employment taxes. Sometimes the worker is simply labelled as self-employed. In other cases the intermediary will set up the contract with the worker so it allows that the worker could send someone else to do their job. In reality this could not, and does not, happen.[87]

The consultation document set out the way employment agencies had to account for tax and NICs in relation to payments made to a worker they placed with a client, *if* the worker met certain criteria – principally, that they provided their services personally:

> The existing legislation in this area comprises separate legislation which applies to Income Tax and NICs …
>
> **Income Tax Legislation**
>
> The income tax legislation is contained at sections 44-47 of the *Income Tax (Earnings & Pensions) Act (ITEPA) 2003* [the 'Agency legislation']. For the legislation to apply to a person's engagement, four conditions (under s44(1) (a) –(d) of the legislation) **all** must be met:
>
> (a) The worker personally provides, or is under an obligation personally to provide, services to another person. This is where an intermediary supplies a worker to an end client;
>
> (b) The services are supplied by or through an intermediary or third party under the terms of an agency contract;
>
> (c) The worker is subject to (or to the right of) supervision, direction or control as to the manner in which the services are provided; and
>
> (d) Any payments are not already taxed as employment income.
>
> The worker must be providing their services under the terms of an agency contract. The legislation defines an agency contract as being: "A contract made between the worker and the agency under the terms of which the worker is obliged to personally provide services to the client."
>
> Where the above conditions are met, the payment received by the worker is treated as being in consequence of an employment between the intermediary (agency) and worker. This means that

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86 HMRC, *Onshore Employment Intermediaries: False Self-Employment*, December 2013

87 *op.cit.* p7

> the intermediary (agency) must deduct Income Tax at source from the worker. Similar provisions apply for National Insurance.
>
> **National Insurance Legislation**
>
> The relevant National Insurance legislation is contained within the *Social Security (Categorisation of Earners) Regulations 1978*:
>
> - Schedule 1, Column (A) paragraph 2 and Column (B) paragraph 2; and
> - Schedule 3 Column (A) paragraph 2 and Column (B) paragraph 2.
>
> and the Northern Ireland equivalent (the *Social Security (Categorisation of Earners) (Northern Ireland) Regulations 1978*).
>
> These Regulations dictate that a person (the worker) will be treated as being an "employed earner" for the purpose of NICs when they meet the conditions in the Regulations. When someone is an employed earner for NICs then employer NICs is payable by the employer (or deemed employer for NICs purposes i.e. the intermediary) and the worker has to pay Class 1 employee NICs rather than Class 2 and Class 4 NICs that apply to the self-employed.
>
> The tests in the NICs legislation are very similar to those in the tax legislation. They require the worker to be subject to, or the right of, direction, supervision or control and that the worker provides their services personally.[88]

Many intermediaries avoiding tax and NICs were doing so by exploiting the test that agency workers should provide their services *personally*:

> [These intermediaries] … attempt to sidestep this test by claiming that there is no obligation for the worker to provide their services personally. This may be done by including a clause in the contract that states the worker is able to send someone else to do their work. In fact this is often not the case because in reality the engager wants that specific worker. There is often collusion between the parties, as they all benefit from presenting the worker as being self-employed. In such cases it can be difficult for HMRC to prove that the reality of the situation is different from that presented in the contracts.[89]

The consultation document set out three scenarios that intermediaries were using to disguise the worker's employment status:

> In the first scenario the employer of the worker moves a number of their existing employees from being employed directly to engaging them through an intermediary on a self-employed basis. The duties that the workers undertake remain the same; it is only the employment status of the worker that changes.
>
> In the second scenario a new worker may agree terms with the engager including pay but the engager then stipulates the worker must be paid by a specific employment intermediary or they will not be engaged.
>
> A third scenario involves the supply of temporary labour to an end client by an Employment Business. The Employment Business sources the labour, (possibly via other intermediaries) but will give the worker no choice other than to be self- employed. This

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88 *op.cit.* pp13-14. Annex A to the document sets out the legislation. Guidance on its application is given in HMRC's *Employment Status Manual*, from para EMS2000.

89 *op.cit.* p10

> happens even where the worker is clearly under the control of the end user and has to perform the work personally.

This practice often resulted in the individual worker losing their employment rights because they were not classified as an employee, and receiving little or no financial reward:

> In all of these scenarios the worker may be unaware that they are engaged on a self-employed basis and may only discover they are not employed when they attempt to claim holiday pay, sick pay or redundancy pay. In such circumstances the worker will not register with HMRC as self-employed and may have a large unexpected tax bill at the end of the year. In other cases the worker is aware that they are being engaged as self-employed and are incentivised to do so for a small increase in pay. This rarely makes up for the important benefits that the worker has given up. On other occasions the worker is given little choice but to accept the engagement terms as this is the only way they are able to find work.
>
> The worker is usually charged a fee by the intermediary of between £10 and £25 per week. This is charged even where the worker is only working for one day a week; meaning the worker takes home very little for their day's work. HMRC have seen examples where workers have mistaken the fee to the intermediary for a deduction at source for tax.
>
> The engager and employment intermediary often share between them the employer NICs and employment rights savings, with the worker receiving very little, if any, financial benefits from these arrangements.[90]

As a solution the Government proposed that the personal service test should be removed, and the legislation focus on "whether the worker is subject to, or the right of, supervision, direction or control as to the manner in which the duties are carried out." For these purposes, control would mean "that anyone is able to exercise control, or have the right to exercise control about how the work is carried out"

> Other factors will also be considered such as the worker being able to decide when to carry out the work or where but these on their own will not be sufficient to bring someone within the legislation. So if a worker has to carry out their work between certain hours because, for example, this is the only time that the site is open, and has to carry out the work on site but can decide how to do their work and beyond complying with the specification there is no checking of the work then they would be outside of the legislation. However, if someone is able to supervise and could ask for the work to be done in a different way or different work to be done then the worker would be within the legislation.[91]

The onus for proving that someone did *not* meet this control test – and was, in fact, self-employed – would lie with the intermediary. As with the Agency legislation, the Government did not anticipate the new rules applying to personal service companies (PSCs) – as those supplying services through a PSC would not, generally, meet all of the relevant criteria. Draft legislation and guidance were included in the consultation

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90 *Onshore Employment Intermediaries: False Self-Employment*, December 2013 pp11-12

91 *op.cit.* p15

document, and the Government proposed the new rules would take effect from 6 April 2014.[92]

The Government confirmed it would proceed with these proposals in the 2014 Budget; these changes were projected to raise £445m in 2014/15, falling to £425m in 2015/16.[93]

As noted, legislation to give effect to these proposals was included in the *Finance Bill 2014*, with certain amendments in the light of the responses received. Two principal concerns were raised by respondents: that the legislation was being introduced too quickly, and that the control test would be difficult to operate in practice. The Government resisted any delay in the implementation date, but acknowledged concerns about situations when intermediaries are actively misled by a business as to whether a worker meets the control test or not:

> Almost half of stakeholders raised concerns both over the shorter consultation period and that the legislation was being introduced too quickly, suggesting that the measure should take effect from April 2015 instead. Having considered these arguments the Government believes delaying implementation would provide the opportunity for new avoidance arrangements to be put in place and therefore implementation will not be delayed …
>
> The majority of respondents thought the control test would be difficult to operate in practice. Some accountancy firms, accountancy bodies and recruitment representative bodies were concerned about a company's ability to prove a negative i.e. that there is no control over the worker. In response to these issues HMRC is developing extensive guidance to illustrate the control test.
>
> Stakeholders were particularly concerned that they may be provided with fraudulent documents purporting either no control or right of control or that the worker had had income tax and NICs deducted through PAYE by a business further down the contractual chain. The Government recognises the concerns which have been raised about the level of due diligence required in order to try and ascertain supervision, direction or control. The Government has therefore amended its proposal such that where the company has been provided with fraudulent documents PAYE liability will sit with the body providing these documents.[94]

The response document gave an illustration of how this would work in practice:[95]

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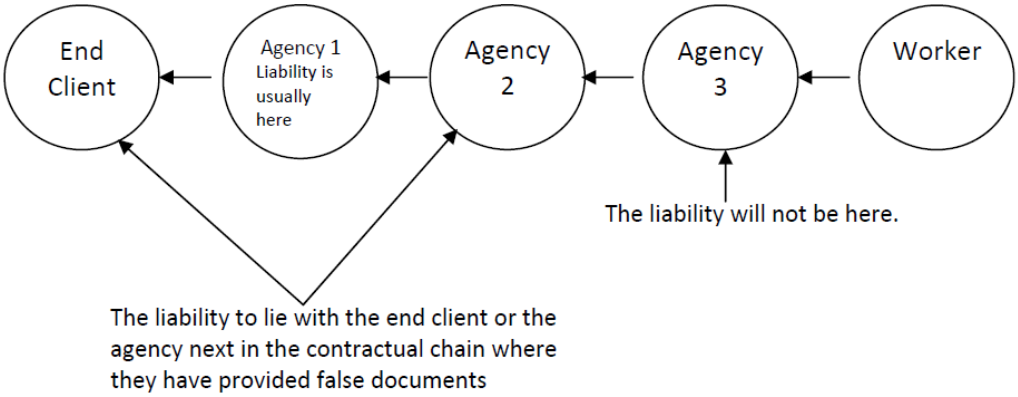
92 *op.cit.* para 4.4, para 4.8, Annex C

93 *Budget 2014*, HC 1104, March 2014 p58 (Table 2.2 – item s).

94 *Onshore Employment Intermediaries: False Self-Employment - Summary of Responses*, 13 March 2014 pp3-4. HMRC also published guidance on the control test at this time.

95 *Onshore Employment Intermediaries*, 13 March 2014 p15



Following the publication of the Bill, Treasury Minister David Gauke announced that both the income tax provisions – in the Bill – and their NICs counterpart – in secondary legislation – would be supported by a targeted anti-avoidance rule, or 'TAAR'. An extract from his statement is given below:

> We have introduced legislation which amends the agency legislation in the Social Security (Categorisation of Earners) Regulations 1978 ("the 1978 regulations") to tackle avoidance, through false self-employment facilitated by intermediaries, of national insurance contributions ("NICs"). We have also introduced legislation, in the Finance Bill 2014, to tackle the same problem in relation to income tax. The amendments to the 1978 regulations will come into force on 6 April 2014, as will the legislation relating to income tax (Budget Resolution No. 11, recorded in the Votes and Proceedings of the House of Commons for 25 March 2014).
>
> The income tax legislation is supported by a targeted anti-avoidance rule ("TAAR") which is intended to ensure that those workers who would be employees, but for the imposition of artificially constructed intermediary arrangements, are treated as employees for the purposes of tax.
>
> I am today announcing that we intend to introduce a TAAR for NICs, with retrospective effect to 6 April 2014, at the next available legislative opportunity. This will support the 1978 regulations and ensure that those workers who would be employed earners but for the imposition of artificially constructed intermediary arrangements are also treated as employed earners for the purposes of NICs. The TAAR for NICs will follow the TAAR for income tax, details of which can be found at clause 16, section 46A of the Finance Bill 2014 which was introduced into the House of Commons on 27 March 2014.[96]

This option had been raised in the consultation, and in its response document the Government gave more details as to why it had decided to introduce this rule:

> The Government is aware that certain elements in the temporary labour market are quick to react to any legislative changes and to find new vehicles to reduce their income tax and NICs. The

[96] HC Deb 3 April 2014 cc89-90WS. A TAAR is used to frustrate avoidance schemes exploiting a specific area of the tax code by allowing the court to consider the *purpose* of a scheme, rather than being restricted to assess whether the scheme delivers the promised tax saving according to the strict letter of the law. (Institute for Fiscal Studies, *Countering tax avoidance in the UK*, February 2009 pp25-28)

> Government therefore intend to introduce a TAAR in the legislation to deter such avoidance. It is designed to enable HMRC to consider both
>
> 1. the motive for setting up the arrangements – whether it is set up with the motive of avoiding income tax, and
> 2. what it achieves – whether it results in less income tax being paid.
>
> This means that people who set up personal service companies (PSCs) for a reason other than reducing tax – such as the limited liability protections incorporation provides – would not be within the TAAR. However, HMRC would be able to use the TAAR in the most egregious cases where, for instance, an agency requires all of their workers to set up a PSC to avoid the new legislation. HMRC will continue to monitor activity in these areas.[97]

The provisions in the Finance Bill to make these changes were debated, and agreed, without amendment, on 1 May 2014.[98] Speaking for the Opposition Cathy Jamieson said that "in general terms, we are pleased that the Government are introducing these measures" but raised concerns as to whether HMRC had sufficient resources to monitor and police the new arrangements, particularly in relation to bogus self-employment:

> Legislation can be one thing, but the how guidance is framed and offered to people to enable changes to be made is also important … Perhaps the Minister will say something about the guidance that will be provided to ensure that the large numbers of people affected by the changes are aware of their new obligations and absolutely clear about the penalties for non-compliance. It needs to be made abundantly clear not only that people will be expected to comply, but that action will be taken against those who choose to ignore the new arrangements.[99]

In response Treasury Minister David Gauke gave an overview of these clauses:

> The avoidance [targeted by these provisions] … takes two forms: falsely presenting employees as self-employed, and placing the employer or employment business of the UK worker outside the UK. Both those models rely on standardised substitution clauses within contracts in an attempt to avoid existing agency legislation, and clause 16 strengthens the existing agency rules to stop that.
>
> The clause also introduces a targeted anti-avoidance rule to prevent people from setting up even more convoluted arrangements in an attempt to avoid the changes. We recognise that there may be times when fraudulent documents are provided to employment intermediaries. Such documents might claim that the worker is either already having pay-as-you-earn deducted, or is not subject to supervision, direction or control. To deal with that possibility, we have included a provision that deems the person who provided the fraudulent documents to be the employer for tax purposes.

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97 *Onshore Employment Intermediaries*, December 2013 para 4.12; *Onshore Employment Intermediaries*, 13 March 2014 para 3.67-9

98 Public Bill Committee (Finance Bill), *Fourth Sitting*, 1 May 2014 cc112-128. They now form ss16-18 & s20 of *FA2014*.

99 *op.cit.* c113, cc115-6

> Clauses 17, 18 and 20 support clause 16.
>
> Clause 17 allows HMRC to transfer a company's outstanding pay-as-you-earn debts to directors where HMRC has used the targeted anti-avoidance rule or the provision relating to fraudulent documents. Clause 18 provides HMRC with the power to create legislation requiring employment intermediaries to keep records, to provide them to HMRC and to penalise the intermediaries if they fail to do so. The clause supports HMRC's compliance work, ensuring that it is targeted where the risk is highest. Clause 20 clarifies that where a UK employment intermediary has placed workers who are being employed or engaged outside the UK, it is the UK employment intermediary that is responsible for administering pay-as-you-earn.[100]

Mr Gauke went on to address Ms Jamieson's concerns as to the level of awareness across the industry of the new rules, and HMRC's work to ensure compliance:

> HMRC and the Treasury have met extensively with people in the industry and representative bodies. Guidance has been published to ensure that people know when and how the changes will apply. As to whether this could affect the genuinely self-employed, while the absence of any obligation to provide a personal service has long been held as an indicator of self-employment, and it is also most unlikely for a person who is personally providing their services in a genuinely self-employed capacity to be under the supervision, direction or control of someone else, the inclusion of a standardised substitution clause within contracts has for too long been used as a way of avoiding being caught by the agency legislation …
>
> In terms of monitoring compliance in the construction sector specifically, all subcontractor payments made are returned to HMRC under the construction industry scheme. That will enable a close monitoring of the extent of non-compliance.
>
> On the impact on business generally, particularly in the construction sector, the measure will create a level playing field for businesses, ensuring that compliant UK businesses that facilitate the UK's extremely flexible labour market are not undercut by those seeking to avoid tax.[101]

On this occasion the Opposition had tabled a new clause to require the Government to review the case for a statutory test of the employment/self-employment divide. Mr Gauke argued that the inherent difficulties to this approach remained:

> I am sure that some hon. Members remember the 2009 proposals, which involved moving from the long-standing case law approach to determining employment status based on a series of absolute tests.
>
> Case law gives flexibility to accommodate genuine diverse engagement practices. Absolute tests do not have subtlety and are therefore hard to design. As set out in the consultation response document, stakeholders at the time felt that the criteria proposed could undermine legitimate commercial practice, as well as risk capturing large numbers of genuinely self-employed workers, particularly in a sector such as construction, where the

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100 *op.cit.* cc122-3
101 *op.cit.* c127

> difference between employed and self-employed is not always obvious.
>
> The Government believe that the changes introduced by clauses 16 to 18 represent a more targeted way of tackling false self-employment, in a way that will not inadvertently impact on the genuinely self-employed.[102]

In the event the new clause was not moved, and these provisions were agreed without division.

Writing on this issue in October 2014, the tax barrister Jolyon Maugham suggested that it was misconceived to imagine that there were legislative solutions to this problem:

> It is undoubtedly true that there are some workers who are wrongly treated for tax purposes by their engagers as self-employed when they are employed. But that is not a problem that requires legislative solution: the Tax Tribunal is perfectly able to address it without recourse to any of the provisions set out above. All the Tribunal need do is ask whether the worker is employed or self-employed.
>
> The real problem (in this context) with the Tax Tribunal – as we know but do not say – is that the assessment of a worker as employed or self-employed is a fact rich one. In consequence, it is usually disproportionately (compared with the value of the arbitrage) resource intensive for HMRC to tackle the question worker by worker.
>
> The legislative solution that is offered is to substitute a less fact rich assessment. But this is, of course, a solution to a different problem (resourcing rather than wrongly characterisation). And these solutions create a different issue: that of false employment.[103]

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[102] *op.cit.* c126

[103] "The challenges of taxing employment (II) : false self-employment", *Waiting for Godot: musings on tax* blog, 6 October 2014

4. Further debate of employment status & tax

4.1 The OTS report on Employment Status

In its first Budget in June 2010 the Coalition Government announced the establishment of a new independent body to review the tax system and make recommendations for its simplification – the Office of Tax Simplification (OTS).[104]

As discussed in the first section of this paper, in March 2015 the OTS published its last report of the 2010-15 Parliament, looking at employment status. As the authors observed in their foreword, employment status was "a complex and wide-ranging subject that many have said has no real solution – and that if we did manage to 'solve it', we should immediately move on to world peace as we'd clearly be on a roll." While the report did not offer "the tax equivalent of the philosopher's stone", it made the case that this was a real problem, one that, due to changing work patterns, "was getting worse":

> The tax system is still in many ways stuck in an out-of-date mindset: of categorising workers as either employees, firmly on the payroll, or self-employed, with the traditional jobbing plumber in mind. This made sense in the 1950s and 1960s but the huge growth in freelancing as a way of life (and work) doesn't fit readily into this traditional model. That growth stems from the IT industry, but has spread far beyond it, facilitated by the internet and (nowadays) 'apps'. Some people may be forced into this form of working but more choose it and value the flexibility it brings. All of this leads some to suggest that the tax system needs to recognise a 'third way' of working.[105]

The authors noted that, in developing their ideas, they "kept coming back to three key points":

> 1 The tax (mainly NICs) differential between employees and self-employed is significant; as long as it exists there will be pressures on the employment status boundary from those who wish to gain an advantage or manage the risk of getting it wrong.
>
> 2 Often of greater significance to business is the issue of employee rights.
>
> 3 Because the dividing line for employment status is blurred rather than clear, it brings a lack of certainty and invites attempts to 'game' the rules.[106]

The report made 28 recommendations spanning questions of administration, legal definition and tax incidence. Among these recommendations the authors suggested that the Government should consider two options to simplify the determination of employment status:

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104 *Budget 2010*, HC 61 June 2010 para 1.64
105 *Employment Status report*, March 2015 pp1-2
106 *op.cit.* p6

- Setting a 'de minimis' level of payment or period of time for any contract, where the person providing their services would definitely not be classified as their client's employee.
- Establishing a statutory employment test.[107]

The OTS also argued that the Government should initiative a joint review between HMRC, HMT, DWP and BIS, to look "at the possibility of developing an agreed code of principles on employment status":

> Ideally there would be an agreed, coherent set of principles developed from case law to guide and govern decisions on employment status. In an ideal world that set of principles would apply to all relevant areas: tax, National Minimum Wage, benefits and employment law.
>
> However desirable, that goal seems unlikely to be achieved, not least because of constantly changing circumstances and the tendency of cases to be taken that seek to distinguish previous decisions. It would, though, be the basis of a statutory test if it is decided to introduce one.
>
> One advantage of an agreed set of principles would be that where decisions are taken to introduce statutory rules, there would be clear bases for the changes. Whether or not the set of principles can be developed, any statutory changes that are made need to assess the impact on the general principles that do exist as part of the process of consultation.[108]

In the report's discussion of longer-term options to simplify employment status, one point is worth highlighting; as the authors put it, "if progress is to be made in 'solving' employment status as an issue, it is difficult to see how this can really be made without tackling NICs" – particularly in respect of the contributions paid by *employers*:

> **Longer term ideas to explore**
>
> The main onus [for proving an individual's employment status] is currently on the business (hence the tendency to 'solve' the situation by hiring only through an intermediary) … We think there is a need to put more of the onus/responsibility on the individual … Something that would help many businesses would be a set 'de minimis' level in the employment status (ES) area. The principle would be that someone who is paid under a set amount or works for less than a defined period would never be regarded as an employee …
>
> We think that a statutory employment test needs to be explored further … There are two approaches possible:
>
> - a detailed, complex exposition that would aim to reflect all relevant case law
> - a simple or pragmatic set of rules that would have rough edges
>
> There was a lot of support for exploring the idea, though much of that support was predicated on the statutory employment test applying 'across the board' – so to employment rights in particular and areas such as benefits and auto-enrolment. This is a key point that needs to be explored: whether or not we end up with a

[107] For details see paras 6.15 and 9.53 respectively.
[108] *op.cit.* p45

> statutory rule, there is an almost universal call for rules to apply to both tax and employment rights …
>
> If progress is to be made in 'solving' employment status as an issue, it is difficult to see how this can really be made without tackling NICs: the differences between NICs and income tax and, of course, the differing NICs rates. The OTS has recommended the integration of income tax and NICs in the past in a number of our reports and we do so again in [this report] … There is a strong case for evening up NICs (and consequent benefits entitlement) between employment and self-employment (ignoring employers' NICs at this stage).
>
> But employers' NICs is the real 'elephant in the room'. It is not an easy thing to tackle, given the money it raises, but it is key to 'solving' the employment status issue. If it could be tackled, many of the problems go away – though differences around employment rights would remain. We have some ideas for making progress here but the starting point is more honesty and transparency about the levy: if more people realise how much it costs/raises, would there be more support for looking afresh at how to raise the money involved?[109]

In his 2015 Budget speech the then Chancellor, George Osborne, announced two important proposals for the next Parliament to simplify personal taxation:

> Businesses, like people, want their taxes to be low. They also want them to be simple to pay. We set up the Office of Tax Simplification at the start of this Parliament, and I want to thank Michael Jack and John Whiting for their fantastic work in this regard. To support 5 million people who are self-employed and to make their tax affairs simpler, we will, in the next Parliament, abolish entirely class 2 national insurance contributions for the self-employed.
>
> Today, we can bring simpler taxes to many more people. Some 12 million people and small businesses are forced to complete a self-assessment tax return every year. It is complex, costly and time-consuming. So, today I am announcing that we will abolish the annual tax return all together. Millions of individuals will have the information the Revenue needs automatically uploaded into new digital tax accounts. A minority with the most complex tax affairs will be able to manage their account online. Businesses will feel like they are paying a simple, single business tax, and again, for most, the information needed will be automatically received.
>
> This revolutionary simplification of tax collection will start next year, because we believe that people should be working for themselves, and not for the tax man. Tax really does not have to be taxing, and this measure spells the death of the annual tax return.[110]

The Budget report gave details of how the Government would proceed with replacing the annual return:

> As a first step, the government will:
>
> - publish a roadmap later this year setting out the policy and administrative changes needed to implement this reform

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[109] *op.cit.* pp9-10
[110] HC Deb 18 March 2015 c777

- introduce digital tax accounts for all 5 million small businesses and the first 10 million individuals by early 2016
- abolish Class 2 NICs in the next Parliament and consult on reforming Class 4 NICs to include a contributory benefit test.[111]

Treasury Minister David Gauke referred to both of these proposals in his initial response to the OTS' report on employment status, and its report on partnership taxation published earlier in the year:

> Before I address your recent reports, I want to highlight a major announcement in the Budget on our plans to modernise tax administration. This sets out our intention to transform how individuals and small businesses engage with the tax system over the next parliament, with every taxpayer able to manage their tax affairs through their digital account.
>
> It will mean the end of the tax return for millions of individuals (including many pensioners, as you have championed). Small businesses will only have to provide information once, be able to link their accounting software to their digital account, and if they wish they will be able to pay as they go so that it will feel like paying one tax. It also means that those who use the cash basis introduced following your small business review will not have to do an end-of year tax return at all (around a million small businesses used the cash basis in its first year of operation in 2013-14).
>
> Building on another of your recommendations, the Chancellor also announced that we will abolish Class 2 NICs in the next Parliament and consult on reforming Class 4 NICs to include a contributory benefit test. This will simplify NICs for five million self-employed people.

Mr Gauke went on to say the Government would consider the OTS' recommendations regarding employment status in the next Parliament:

> I welcome your report and think you have effectively highlighted the challenges of ensuring the tax system reflects the reality of the modern day labour market, and of providing certainty for individuals and employers. As you note, there are no 'quick wins' here, but I believe there is considerable merit in some of your more ambitious and longer term recommendations.
>
> There are trade-offs between which of these to pursue and we will need to work through the broader implications of any change, including the impact on employment law. The government will therefore consider the recommendations carefully in shaping its programme of tax reform and administration for the next parliament.[112]

In July 2015 the OTS published a summary of the responses it had had to its report on employment status, in which it noted the "wide range of press comments on the report when it was published: these were, pleasingly, almost universally supportive of the report and its ideas."[113] Two respondents had made points in relation to the specific question of a statutory test for employment status:

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111 *Budget 2015*, HC 1093, March 2015 para 1.109. For details on the first of these reforms see, *Making Tax Digital*, Commons Briefing paper CBP7949, 17 July 2017.
112 *Letter from the Financial Secretary to the OTS on Budget 2015*, 19 March 2015
113 OTS, *Employment Status Report – follow up summary of responses*, July 2015 p1

> A respondent to the report was in favour of a court based approach, with guidance picking up on employment law principles established, rather than a targeted statutory test which could fail to achieve practical effect.
>
> An industry representative commented that a simple short set of quantitative tests may be the only workable solution, but this could also prove to be draconian, dragging in too many contractors who are genuinely in business on their own account. It was considered the test would also need to replace IR35, and it was likely that enforcement would be very difficult.[114]

In November 2015 the Government announced that it would take forward the majority of the OTS's recommendations.[115] In a letter to the OTS Treasury Minister David Gauke confirmed that the Government would set up a cross-government working group for employment status, and that it would consider looking at a statutory employment test, although he rejected the idea of a 'de minimis' test, on the grounds that this would increase the risk of tax avoidance. An extract from Mr Gauke's letter is reproduced below:

> As your review found, the dividing line between employment and self-employment can differ depending on whether status is being decided for the purposes of employment law or tax. This is a complicated situation which can cause confusion for both workers and employers. To help to address this, I have asked officials to establish a Cross Government Working Group for Employment Status. The intention is for this group to include representatives from HM Revenue and Customs (HMRC), HM Treasury, the Department for Work and Pensions (DWP) and the Department for Business, Innovation and Skills (BIS). The Working Group will consider the benefits of and barriers to an agreed set of employment status principles and a statutory employment status test.
>
> Since the publication of your report, BIS have asked Julie Deane OBE to carry out a review of self-employment in the UK. DWP have also launched a review of business start-ups and entrepreneurship in disadvantaged communities, which will be led by Baroness Mone.
>
> I believe it would be premature to establish a separate review of employment status while these two reviews are taking place, though I expect that the Working Group will consider any relevant findings. I have written to DWP and BIS ministers and intend for the group's first meeting to take place in early 2016.[116]

An appendix to the Minister's letter showed that the Government had accepted 17 of the report's recommendations, and would consider another 6. The OTS had floated the idea of increasing the transparency around employers' NIC, on the grounds that this might provoke a better-informed debate on how best to reform the tax. This proved to be one of its recommendations that the Government rejected, arguing that "including employer's NICs on payslips will decrease simplicity for individuals." The report had also raised the much wider question of merging NICs with income tax, something that the OTS recommended

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114 *op.cit.* p4
115 *Spending Review & Autumn Statement*, Cm 9162, November 2015 para 3.97.
116 *Letter from the Financial Secretary to the Treasury to OTS on Autumn Statement 2015*, 26 November 2015

in a review of small business taxation published in 2011.[117] The Minister's letter simply stated that the Government would 'consider' this suggestion - although this is something that has been debated, off and on, for many years, with little indication that governments are keen to pursue such a radical reform.[118]

In February 2016 the Department for Business, Innovation & Skills published the review of self-employment it had commissioned from Julie Dean, the founder and CEO of the Cambridge Satchel Company. Ms Dean's report made a series of recommendations, and suggested that the Government should consider a single statutory definition of self-employment for tax and employment law:

> The description of 'self-employed' applies to farmers, taxi and cab drivers, those running their own businesses, freelancers and contractors. There is no clear understanding of the employment status within many of these groups …
>
> The lack of a formal definition of self-employment should not be an issue for individuals seeking to set up their own business. However, the results from the call for evidence were stark – 36% "strongly agreed" and 22% "agreed" that the lack of a legal definition of self-employment was an issue for them.
>
> To add to the confusion there is also a tax definition of whether or not someone is 'employed' or 'self-employed'. For the purposes of tax this definition is important as it has a direct bearing on what tax and National Insurance liabilities exist. Whilst this is outside the scope of this review, it is clear that simplification and clarification of a single definition for tax and employment law is highly desirable.[119]

In March the Department for Work & Pensions published Baroness Mone's review of business start-ups in disadvantaged communities, although the report made no mention of this issue.[120] That same month the Government confirmed that the Departmental internal review of employment status had been concluded, and that, "Ministers are carefully considering whether further steps are required to improve clarity and transparency for employers and individuals alike."[121]

4.2 Budget 2017 & the Taylor Review

Over the last year there have been a series of related developments regarding the self-employed: debates as to the impact of the gig economy and the employment rights of freelancers; analysis of the tax drivers to individuals taking up self-employment or incorporation; and, in the 2017 Budget, proposals to reform National Insurance contributions as paid by the self-employed. In the latter case, the Budget proposed abolishing Class 2 NICs from April 2018, and

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117 For details see, OTS, *Small business tax review*, March 2011 paras 3.12-4.

118 The issue is discussed at length in, *National Insurance contributions: an introduction*, Commons Briefing Paper CBP4517, 17 July 2017.

119 *Self-Employment Review: an independent report*, BIS February 2016 p27. In answer to a PQ in May 2016, the Government stated it was "considering all the recommendations made in Julie Deane's independent review of self-employment and will respond in due course" (PQ36162, 5 May 2016).

120 DWP press notice, *Baroness Mone publishes 'Be the boss' review*, 1 March 2016

121 PQ29005, 4 March 2016

increasing the rate of Class 4 NICs in two steps, in April 2018 and April 2019. Subsequently the Chancellor Philip Hammond announced on 15 March that the Government would ***not*** proceed with the increases in Class 4 NICs.[122] A few months later, in November 2017 the Government stated that the abolition of Class 2 NICs would be deferred a year, to April 2019,[123] and in September 2018 Treasury it announced it would not proceed with the abolition of Class 2 NICs "during this Parliament … given the negative impacts it could have on some of the lowest earning in our society."[124]

In addition in October 2016 the Prime Minister Theresa May appointed Mr Matthew Taylor (Chief Executive of the Royal Society of the Arts) to lead a review "to consider how employment practices need to change in order to keep pace with modern business models."[125]

Mr Taylor published his report in July 2017, making a series of recommendations covering a variety of issues in relation to the 'gig economy'.[126] Though the review's remit did not extend to making proposals for tax changes, it discussed the distortions created by the different ways that employment and self-employed were taxed, such as the bogus claiming of self-employed status by both individuals and businesses, and argued that "the principles underlying the proposed NI reforms in the 2017 Spring Budget are correct":

> The level of NI contribution paid by employees and self- employed people should be moved closer to parity while the Government should also address those remaining areas of entitlement – parental leave in particular – where self-employed people lose out.[127]

Taylor also recommended that "renewed effort should be made to align the employment status framework with the tax status framework to ensure that differences between the two systems are reduced to an absolute minimum." As noted above, employment law has a tripartite classification of employees, workers – more accurately termed 'limb b' workers, and the self-employed. Taylor argued that both employees and 'limb b' workers – 'dependent contractors' as he suggested they be termed – should both be regarded as employed for tax purposes:

> While self-employment is not an employment status, Government should aim for 'self-employed' to mean the same for both employment rights and tax purposes.
>
> **In developing the new 'dependent contractor' test, renewed effort should be made to align the employment status framework with the tax status framework to ensure that differences between the two systems are reduced to an absolute minimum.**

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122 For details see, *Spring Budget 2017: a summary*, Commons Briefing paper CBP7919, 17 March 2017.

123 Update on the National Insurance Contributions Bill: Written statement HCWS220, 2 November 2017

124 National Insurance Contributions: Written statement HCWS944, 6 September 2018

125 Details on the Review are on Gov.uk.

126 The Review is discussed in detail in, *Employment status*, Commons Briefing paper CBP8045, 28 March 2018 (see section 7).

127 *Good work: the Taylor Review of Modern Working Practices*, July 2017 p72

> The dividing line should be between the new dependent contractor status outlined and self-employment so that being employed for tax purposes naturally means an individual is either an employee or a dependent contractor. Government could also consider how tax tribunal and employment tribunal rulings could be applied across jurisdictions – for example, in the shorter term and until the systems are aligned, Government could ensure that where a tribunal determines that an individual is an "employee" for tax purposes, that decision is also binding for employment law purposes.[128]

In its report on the gig economy published in May 2017, the Work & Pensions Committee made similar recommendations regarding the equalisation of NICs, and the employment status of 'workers':

> Our welfare system, and public support for it, is founded on the contributory principle. The introduction of the New State Pension means the last major difference between the entitlements of employees and self-employed has been removed. It is now difficult objectively to justify the differing rates of contribution. Fairness must be the future direction of travel and, political constraints aside, the equalisation of NICs rates was right.
>
> *The incoming government should set out a roadmap for equalising the National Insurance contributions made by employees and the self-employed* …
>
> Designating workers as self-employed because their contract offers none of the benefits of employment puts cart before horse. It is clear, though, that this logic has taken hold, enabling companies to propagate a myth of self-employment. This myth frequently fails to stand up in court, but individuals face huge risks in challenging their employment status in that way. Conversely, where there are tax advantages to both workers and businesses in opting for a self-employed contractor arrangement, there is little to stand in the way. It is clear that current ways of categorising workers are creaking under the weight of the changing economy.
>
> The apparent freedom companies enjoy to deny workers the rights that come with employee or worker status fails to protect workers from exploitation and poor working conditions. It also leads to substantial tax losses to the public purse, and potentially increases the strain on the welfare state.
>
> *An assumption of the employment status of "worker" by default, rather than "self-employed" by default, would protect both those workers and the public purse and would put the onus on companies to provide basic safety net standards of rights and benefits to their workers. This assumption would entitle workers to employment rights commensurate with "worker" status. As there is no "worker" status in tax law, tax status would be unaffected. Companies wishing to deviate from this model would need to present the case for doing so, in effect placing the burden of proof of employment status on the company.*[129]

Notably when BEIS Minister Margot James made a statement to the House on the publication of the review, she *ruled out* revisiting the question of reforming Class 4 NICs:

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128 *op.cit.*, July 2017 p38

129 *Self-employment and the gig economy*, 1 May 2017, HC 847 of 2016-17 para 10, paras 20-21

> **Rachel Reeves (Leeds West) (Lab) :** Matthew Taylor said today that he wants employers to pay national insurance for people with whom they have a controlling and supervisory relationship. Do the Government plan to implement that aspect of the Taylor review, and can the Minister reassure workers that the Government do not plan to U-turn on their U-turn and increase national insurance for the genuinely self-employed?
>
> **Margot James :** I can assure the hon. Lady that … Parliament has spoken on the issue of national insurance class 4 contributions. That matter is now settled, and will not be revisited. I agree with her that we should pay close attention to ensure that people who are genuinely contracted to provide an ongoing service are given the protections that workers enjoy, and are not falsely labelled as self-employed. [130].

Initially the Government anticipated giving a formal response to the Taylor review by the end of the year, but in the event this was published on 7 February 2018. As part of this the Government launched a consultation on employment status:

> Employment status is an important and complex issue that is central to both the employment rights system and the tax system, and so any potential changes need to be considered carefully. It is important that any action the government takes preserves flexibility in our labour market, does not impose unnecessary burdens on businesses, and does not create an adverse impact on the ability of those in the UK labour market to work, or how they work. It is for this reason that the government is publishing a consultation authored jointly by BEIS, HM Treasury, and HM Revenue and Customs exploring the options for reforming employment status for both employment rights and tax in order to achieve greater clarity and certainty.[131]

At the same time the Government ruled out any reforms to the level of NICs paid by the self-employed:

> The review … recommended that the principles underlying the proposed National Insurance (NI) reforms in the 2017 Spring Budget were correct. The level of NI contributions paid by employees and self-employed people should be moved closer to parity, at the same time as being taken to address those remaining areas of entitlement – parental leave in particular – where self-employed people lose out …
>
> While we agree with the review that the small differences in contributory benefit entitlement no longer justify the scale of difference in the rates of NI contributions paid in respect of employees and the self-employed, we are clear that we have no plans to revisit this issue. The government also agrees with the principle of equalising benefits for the self-employed, but as the review says, it is right to only consider making changes to this area once we have carefully considered this in the wider context of tax, benefits and rights over the longer term.[132]

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130 HC Deb 11 July 2017 cc162-3. See also, PQ901, 28 June 2017

131 HM Government, Good work: a response to the Taylor Review on Modern Working Practices, February 2018 p31

132 *op.cit.* pp64-5. See also the comments made by the BEIS Minister Andrew Griffiths when he made a statement to the House: HC Deb 7 February 2018 c1501.

Details of the Government's consultation on employment status are on Gov.uk.[133]

In its consultation document the Government asked for views on the codification of current case law, and alternative approaches for providing individuals and businesses with clarity, as well as for views on updating the current employment status tests. In the latter case the consultation suggested that the status test could have more precise criteria or a more precise structure, and cited, as a possible model, the statutory test for residence for tax purposes. Notably the Government took the view that *self-employment* should not be defined in law:

> One potential risk of defining self-employment in legislation is that it could result in a court not being able to make a judgement on someone's employment status as their circumstances might not fit into any of the statutorily defined employment statuses.
>
> Others have raised the risk that defining self-employed in legislation provides unscrupulous employers the opportunity to game the system by designing contracts or work practices to fall within the letter, but not the spirit, of that definition.
>
> The government recognises and agrees with these risks, and therefore, on balance is not attracted to the idea of defining an additional category of self-employed in statute.[134]

It also expressed some reservations as to whether fully aligning the status frameworks for tax and for employment law would be a sensible reform:

> [The Taylor review] noted that the lack of alignment between the two systems causes confusion for individuals and businesses, and recommended that the definition of self-employed should be aligned as far as possible in the longer term, by having both individuals who are employees and those who are workers or dependent contractors being subject to the employment tax regime.
>
> Additionally, some commentators have suggested that having the same terms meaning different things across rights and tax can be problematic … However, other commentators have pointed out that the two systems are trying to achieve different objectives: one deciding who is entitled to certain employment rights and the other determining the tax regime that applies to the income they receive. Therefore, aligning definitions across the two systems could create steeper cliff edges and stronger incentives for miscategorisation …
>
> This recommendation would result in all workers – i.e. Limb (b) workers and employees – paying tax on the same basis as employees. At present, Limb (b) workers are usually taxed on a self-employed basis, and so this would be a significant change for impacted individuals and businesses. Therefore the impacts of this proposal would need to be carefully considered.[135]

Notably, in its foreword, the Government underlined its view that, "employment status has wide reaching effects, and we are clear that

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133 See also, BEIS press notice, *Millions to benefit from enhanced rights as government responds to Taylor review of modern working practices*, 7 February 2018.
134 Employment status consultation, February 2018 para 9.3-5
135 *op.cit.* para 10.2-5

the detail of any reforms would need to be consulted on. If the government decides to press ahead with significant changes, we would of course ensure that businesses and individuals are given plenty of time to adjust and prepare."[136] The consultation closed on 1 June, and to date the Government has not published its response.

[136] *op.cit.* pp2-3

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