



Chartered
Institute of
Taxation
Excellence in Taxation

Employment Status Consultation Response by the Chartered Institute of Taxation

1 Introduction

- 1.1 The Chartered Institute of Taxation's (CIOT) comments on the tax system aspects of the government's Employment Status Consultation (published in February 2018) are set out below.
- 1.2 Employment status is at the core of the tax system. It determines the taxes a worker, and the business the individual works for, must pay. However, establishing the correct employment status of a worker can often be far from straightforward. It is therefore right that the government reviews how employment status is determined, the interaction with employment rights and whether the present approach can be improved.
- 1.3 As an educational charity, our primary purpose is to promote education in taxation. One of the key aims of the CIOT is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. Our comments and recommendations on tax issues are made solely in order to achieve this aim; we are a non-party-political organisation.
- 1.4 Our stated objectives for the tax system include:
 - Greater simplicity and clarity, so people can understand how much tax they should be paying and why.
 - Greater certainty, so businesses and individuals can plan with confidence.
 - A fair balance between the powers of tax collectors and the rights of taxpayers (both represented and unrepresented).

- 1.5 Our response focuses on the income tax and national insurance (NIC) aspects of the present consultation. However, as we have said previously¹ we would encourage the government to initiate a broader strategic review of how labour should be taxed in the 21st century with the result being publication of a labour taxes ‘road map’ setting out its thinking in this respect, together with a realistic timetable to implement such changes that are found to be necessary.

2 Executive summary

- 2.1 We welcome the government’s response to the Matthew Taylor review of modern working practices and the decision to consult on employment status for labour law and tax purposes.
- 2.2 As we stated in our response to Matthew Taylor’s review² there *‘needs to be a wide, open and very public debate on the tax treatment of different kinds of work structures’*. Any changes in definitions should be thought through and debated very carefully and widely, and a consensus reached before any codification or legislation is introduced.
- 2.3 As also noted in our response to the Taylor review³ *‘the imbalance between the tax burdens on employment and self-employment remains very large, mainly because of the 13.8 per cent cost of employers’ national insurance (NIC).... This may be the biggest issue to be addressed if the tax system is to keep pace with evolving working practices’*. Hence, there needs to be a more level playing field, or economic pressure to subvert the borderline will continue.
- 2.4 We therefore recommend that the government work with stakeholders, businesses, unions and individuals to facilitate a broader debate to identify what we mean by employment (and self-employment) with a view to agreeing a sustainable solution to how earnings (whether from employment or self-employment) should be taxed, including how we might ‘level the playing field’, and what rights and benefits should be associated with what status. We would urge the government not to rush through legislation without this broader debate; but this debate needs to be taken forward with some urgency.
- 2.5 We believe the way forward, in the short term, is to improve guidance on the existing case law tests of employment status. In this regard, we think a new online tool to help employers and individuals to establish a worker’s employment status is a good idea. Currently, HMRC has the ‘check employment status for tax’ (CEST) tool and while this has its limitations it could be improved. The tool should remain binding on HMRC (assuming the full facts have been disclosed) and could also be extended to reference the employment law position, albeit the parties (engager and worker) should not be bound by the result in the same way as HMRC.

¹ See <https://www.tax.org.uk/policy-technical/submissions/independent-review-employment-practices-modern-economy-taylor-review> at paragraph 1.2 and our Press Releases of 11 July 2017 and 7 February (<https://www.tax.org.uk/media-centre/press-releases/press-release-taylor-may-deliver-fairness-terms-rights-more-work-needed> and <https://www.tax.org.uk/media-centre/press-releases/press-release-ciots-calls-debate-uneven-tax-burden-imposed-employed-and>).

² See <https://www.tax.org.uk/policy-technical/submissions/independent-review-employment-practices-modern-economy-taylor-review> at paragraph 1.2.

³ See <https://www.tax.org.uk/policy-technical/submissions/independent-review-employment-practices-modern-economy-taylor-review> at paragraph 1.3.

- 2.6 Our specific comments on the income tax and NIC aspects of the consultation are set out below but should be considered in light of our preference for a much broader debate.

3 Chapter 4: Issues with the current employment status regimes

3.1 ***Q1: Do you agree that the points discussed in this chapter are the main issues with the current employment status system? Are there other issues that should be taken into account?***

- 3.2 It should firstly be recognised that employment status for the majority of workers is non-contentious – they are either clearly employed or clearly self-employed. However, we agree that for large and increasing numbers of people, especially those operating in the ‘gig’ economy, determining status can be highly subjective and problematic as summarised in Chapter 4 (namely, status can be open to interpretation, complex and it can be difficult to resolve disputes).

4 Chapter 5: Legislating for the current employment status tests

4.1 ***Q2: Would codification of the main principles – discussed in chapter 3 – strike the right balance between certainty and flexibility for individuals and businesses if they were put into legislation? Why / Why not?***

- 4.2 While we would like to see a definitive way to determine whether someone is employed or self-employed for tax purposes we do not believe that codifying the present case law derived tests will provide a solution. This is because it is necessary to ‘*paint a picture*’⁴ taking account of a number of different factors in relation to the positions of the individual and the engager and how they work together. While the factors could be listed out it seems to us doubtful whether this would greatly assist in determining status relative to where we are now.

5 Chapter 6: A better employment status test?

5.1 ***Q23: What is your experience of other tests, such as the SRT? What works well, and what are their drawbacks?***

- 5.2 The statutory residence test (SRT) has the advantage of providing certainty. It also has the advantage of being applied after the event (ie after the end of the tax year) to the factual events of that past year. However, the SRT is not simple – Finance Act 2013, Schedule 45, which legislated for the SRT, contains 159 paragraphs and HMRC’s accompanying guidance extends to more than 100 pages. In our opinion, the key benefit of the SRT is that while it is still complex more of its elements are more objective and less subjective, so it is easier to determine whether an individual is resident or not. This makes the SRT easier to enforce.

⁴ See *Hall (HM Inspector of Taxes) v Lorimer* [1993] EWCA Civ 25 (05 November 1993) and Lord Justice Nolan’s judgment (<http://www.bailii.org/ew/cases/EWCA/Civ/1993/25.html>) and HMRC’s Employment Status Manual at ESM7160 (<https://www.gov.uk/hmrc-internal-manuals/employment-status-manual/esm7160>).

- 5.3 This said, a statutory employment status test that could provide individuals and businesses with certainty as to a worker's status at the start of a contract would indeed be welcome.
- 5.4 A starting point in terms of thinking on a new status test could be to learn from the genesis of the Statutory Residence Test (SRT). In the case of the SRT, before it was decided on whether to legislate around 50 examples were produced for parties to consider and decide on two questions, ie (i) whether an individual was resident or not on existing case law principles and (ii) whether they should be resident under any new rules.
- 5.5 We think something similar could be done for employment status. If, say, 50 different scenarios were produced, the two questions could be (i) is this person employed or self-employed on existing case law principles and (ii) should they be categorised this way. At the very least this would identify the situations where most disagreement on status currently arises and whether there is consensus on what the proper result should be.
- 5.6 Any new test would clearly need to cope with a multitude of different circumstances. This could result in significant complexity rather than being a simple test. On the other hand, if a test was purposefully kept simple this could encourage businesses to adapt their arrangements so as to fall just the 'right' side of the line. In contrast, the current case law derived tests allow courts and tribunals to adapt a more nuanced approach to evolving working practices.
- 5.7 The underlying tax point here of course is that falling the 'right' side of the line – however that line is defined – could save a material amount of employer's NIC.
- 5.8 ***Q25: What is your experience of tests, such as the Agency Legislation tests for tax, and how these have worked in practice? What works well about these tests in practice, and what are their drawbacks?***
- 5.9 The agency legislation at ITEPA 2003, section 44 is based on the concepts of personal service and supervision, direction or control (SDC). While the legislation is indeed very succinct it has nevertheless required extensive HMRC guidance and examples to try to explain the meaning of SDC. Consequently, one drawback of the legislation is that it can be difficult to apply in practice.
- 5.10 This said, if it is decided to retain the category of limb (b) workers for employment law purposes (see below) and to give more prominence to an SDC test, this would then tie in with the existing agency worker test for tax purposes, something which is at least familiar to engagers across the UK.
- 5.11 ***Q28: Are there alternative ways, rather than legislative change, that would better achieve greater clarity and certainty for the employment status regimes (for example, an online tool)?***
- 5.12 Regardless of whether legislative change is considered to be the best way to provide greater clarity on employment status, we think that better guidance is needed to help individuals and businesses determine whether a worker is employed or self-employed for income tax and NICs purposes.
- 5.13 We consider that a technology-based tool to determine whether someone is an employee or self-employed for tax purposes would be helpful and could provide greater clarity, especially where both the engager and the worker separately use the tool. However, such aids must be

reliable and accurate, and test all relevant factors. In this regard, we note that HMRC's check employment status tool (CEST) does not take account of mutuality of obligation. In any event, the tool should remain binding on HMRC (assuming the full facts have been disclosed) and could also be extended to reference the employment law position, albeit the parties (engager and worker) should not be bound by the result in the same way as HMRC. The other point is that if for any reason HMRC's view evolves in terms of its judgment as to whether someone is employed or self-employed the effect of this should only be prospective and not relate back to engagements that commenced prior to the change of view.

- 5.14 ***Q29: Given the current differences in the way that the employed and the self-employed are taxed, should the boundary be based on something other than when an individual is an employee?***
- 5.15 We think that distinguishing the tax treatment of those who are employed and self-employed is increasingly out-dated. Not least given the distorting effect of employer's NIC at (currently) 13.8%⁵. And particularly so given the increasing impact of automation and offshoring on jobs and pay rates. Furthermore, the nature of work in the 'gig' economy is also significantly blurring the difference between employment and self-employment in any event. This said, if the current differences in the way employees and the self-employed (and the businesses that engage them) are taxed are to be retained, we do not see a way of basing the boundary on anything other than whether or not the worker is an employee.
- 5.16 If the concept of 'limb (b) worker' is retained (whether or not redefined as a 'dependent contractor'), we consider that their tax position needs to be clarified. The government also needs to be very clear which people are to be categorised as limb (b) workers and what the point is in distinguishing them for employment rights purposes. Are they, for example, employees with fewer/different employment rights ('dependent contractors') or self-employed with no/some employment rights ('independent contractors'), or a bit of both?
- 5.17 We would, however, reiterate that we do not believe that tax liabilities should depend on being an employee. A core driver in relation to businesses preferring to engage labour on a self-employed basis is the income tax and NICs – especially employer's NICs – imbalance as between the employed and self-employed. While we note that the consultation document states at paragraph 1.7 that this aspect is not within the scope of the consultation, the tax and NICs issues around employment status would fall away if the boundary between employed and self-employed was lessened or removed. Indeed, this argument is implicitly recognised at paragraphs 6.15-6.18 of the consultation document. Hence, we recommend that the government initiate a strategic review of the nature of taxation on employment and self-employment income and what changes may be appropriate in this regard.
- 5.18 We would add that the current NICs system may also encourage zero-hours/low-hours engagement of workers as employer's NICs at 13.8% only applies to weekly earnings over £162. This is another reason why we believe the government should initiate a strategic review of how labour should be taxed in the 21st century and what should be done about employer's NIC⁶. As part of a future public debate as to how labour should be taxed the

⁵ This is not to say that employer's NIC can simply be abolished. But rather to argue it might be replaced by a levy based on business operating costs (or similar) instead so that it does not discriminate against those engaged as employees (see <https://www.tax.org.uk/policy-technical/submissions/independent-review-employment-practices-modern-economy-taylor-review> at paragraph 1.4).

⁶ See footnote to paragraph 5.15.

government could consider redesigning employer's NICs to address what costs it should apply to and how.

6 Chapter 10: Alignment between tax and rights

6.1 ***Q62: If the terms employee and self-employed continue to play a part in both the tax and rights systems, should the definitions be aligned? What consequences could this have?***

6.2 In principle, we think that the alignment of definitions for employment rights and tax purposes is a good idea. We believe that businesses and individuals would welcome one set of rules. It makes life simpler for everybody and avoids confusion.

6.3 This said, and as noted above, if significant differences in the taxation of employed and self-employed labour are retained this is likely to continue to drive behaviour and cause business to adapt their businesses models accordingly.

6.4 We suggest that the labour relations and employment law issues identified in the consultation document be resolved first, ie start by agreeing the definitions for employment law purposes. This should cover the meaning of 'employment', 'self-employment' and 'limb (b) worker', that is if it is still felt that the category of limb (b) worker should be retained⁷. Then decide what employment rights and state benefits attach to each status. Finally, the tax treatment should then attach to the relevant status as defined for employment law purposes. In particular, we think there should be the minimum possible tax exceptions made to this approach.

6.5 That said, we accept that under the current tax and NIC treatment that applies to the employed and self-employed certain anti-avoidance rules may be necessary. For example, as regards agency workers subject to SDC, partners in LLPs subject to the 'salaried member rules' and individuals in personal service companies subject to IR35.

6.6 But we suggest that other exceptions should be removed. For example, the definition of 'earner' for NIC purposes should be aligned with that of 'employee' for tax purposes and the exceptions made in the Social Security (Categorisation of Earners) Regulations 1978 should be reviewed to confirm whether those distinctions are really necessary any longer.

6.7 ***Q63: Do you agree with commentators who propose that employment rights legislation be amended so that those who are deemed to be employees for tax also receive some employment rights? Why/why not?***

6.8 As noted above, we think that a single definition of 'employment' should be driven by employment law considerations, with the income tax and NIC applying accordingly once that definition has been agreed.

6.9 In this respect we note that the IR35 rules provide that individuals who typically own and provide services through their own Personal Service Company (PSC) and who are not employees of their engager for employment law purposes, are treated as employees of the engager for tax purposes. These rules are of course a distortion of the formal contractual position, but they are geared to combatting perceived tax avoidance and it seems unlikely

⁷ See our comments at paragraphs 5.10 and 5.16.

that they will be dispensed with any time soon (at least not given the present differences in the tax and NIC treatment of the employed and self-employed⁸). But whether engagements within IR35 should then trigger any employment rights for the worker with the end user is, we think, a labour relations issue rather than a tax matter.

- 6.10 That said, we think it can be fairly argued that matching one distortion with another is probably not the answer: it simply compounds the cost to business.
- 6.11 Finally, we note that one of the key reasons for the IR35 rules is to counter the potential avoidance of employer's NIC. But this is another illustration of why we believe that the government should take a close look at employer's NIC and review whether it is still fit for purpose⁹.

7 Acknowledgement of submission

- 7.1 We would be grateful if you could acknowledge safe receipt of this submission, and ensure that the Chartered Institute of Taxation is included in the List of Respondents when any outcome of the consultation is published.

8 The Chartered Institute of Taxation

- 8.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT's work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members' experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT's comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT's 18,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA', to represent the leading tax qualification.

The Chartered Institute of Taxation
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⁸ See <https://www.tax.org.uk/policy-technical/submissions/independent-review-employment-practices-modern-economy-taylor-review> at paragraphs 2.5 and 2.6.

⁹ See footnote to paragraph 5.15.