Does the UK need a statutory employment test?

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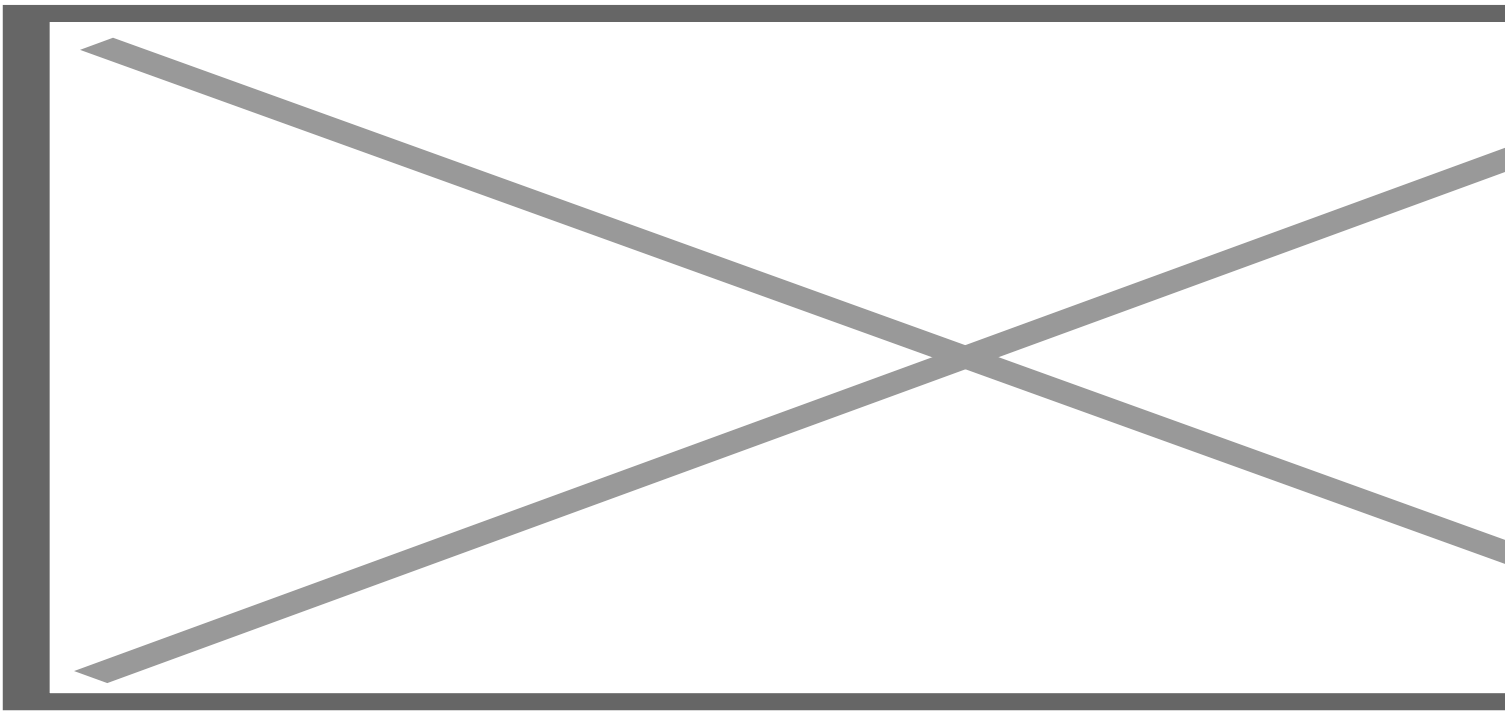

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Lesley Fidler suggests that the UK should stop trying to manage without a statutory employment test

Much has been written on the distinctions between employment and self-employment. Countless hours of court time and even longer in preparation have been spent arguing the matter. Individuals have endured uncertainty for months or years whilst correspondence with HMRC goes backwards and forwards – or lingers. As tax advisers, we tend to see this issue from a cost perspective: to pay or not to pay secondary (employer's) Class 1 national insurance contributions? But of course there is also the employee's side: should a worker automatically enjoy the protection that employment rights bring or have to negotiate for everything?

I believe that the tax system now needs to have a statutory employment test (SET). Indeed, it is hard to see how it can operate effectively without. This is not a new idea. In 2017 the Taylor review (Good Work: The Taylor review of modern working practices: https://tinyurl.com/yaf4fk5e) suggested that 'The aim of a new legislative framework is that the legislation does more of the work and the courts less' (Good Work: The Taylor review of modern working practices, page 32). The BEIS response (A response to the Taylor Review of Modern Working Practices https://tinyurl.com/yadyxzxp) does not reject this recommendation, but it certainly does not promote it as an urgent issue. Many commentators have rejected the idea of a SET because they believe it is not possible to create a set of tests that produce the same result as the current body of case law. This is certainly true. As the Court of Appeal repeated in 1993, 'The object of the exercise is to paint a picture from the accumulation of detail. The overall effect can only be appreciated by standing back from the detailed picture which has been painted, by viewing it from a distance and by making an informed, considered, qualitative appreciation of the whole. It is a matter of evaluation of the overall effect, which is not necessarily the same as the sum total of the

individual details. 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' (Hall v Lorimer 66TC349).

The creators of HMRC's Check Employment Status for Tax (CEST) tool acknowledge this and so there is a rump of difficult cases where the tool holds its metaphorical hands up and admits defeat. The same limitation applied to its predecessor, the Employment Status Indicator that was created with the construction industry in mind. But the objection that a SET cannot be created assumes that a new SET would have to reflect the current position. When the statutory residence test was created much work went into mirroring the common law position, but there were far fewer cases to try and harmonise. I suggest that existing case law, both tax- and employment-related, should be considered, but not necessarily replicated, in a new, objective test.

In 2020, is it right that tax considerations should be governed by a set of common law principles that have their roots in an era of masters and servants, in times when middle-class families had servants and there was a well-developed class system that ensured that gender, birth and connections overrode ability? Working practices have changed in the past two or three decades let alone the greater part of the century since Davies v Braithwaite was decided in 1931. Whilst the tax profession debates the role of artificial intelligence in the tax system, it then for employment status determinations uses outmoded principles that were not designed for a world of careers such as those of IT contractors and project managers: workers whose expertise is essential to businesses but only for discrete periods. Even large employers cannot justify carrying highly specialised knowledge workers on their payrolls until they are needed: nor is this likely to be acceptable to such workers themselves. Surely it is time to look at the tripartite categorisation suggested by the Taylor review, translate (and harmonise) the proposed 'dependent contractor' status derived from the current employment law 'worker' category (Section 230, Employment Rights Act 1996) into the tax system and bring the rules into the second quintile of the twenty first century?

At Rishi Sunak's first cabinet meeting as Chancellor of the Exchequer in February 2020, he reminded his colleagues of his predecessor's challenge for every Department to identify a 5% cut in its spending. It seems unlikely that against this background, HMRC can offer one-to-one advice for large numbers of taxpayers. The current tax system is based on concepts such as self-assessment and pay now – check later. Pre-transaction rulings are only given by HMRC in a narrow range of circumstances. And yet there is requirement on a taxpayer to take reasonable care – a behaviour which is only questioned when HMRC does not agree with the result and which may not even be satisfied by engaging an adviser.

Taxpayers and their advisers therefore need an objective test of employment status so that they can proceed with certainty from the start in all cases. The recent batch of front-of-camera IR35 cases (including, in no particular order, the personal service companies used by Christa Ackroyd, Helen Fospero, Eammon Holmes, Lorraine Kelly and Kaye Adams) have all been concerned with tax years that ended several years ago (for example, in late 2019 Helen Fospero's personal service company, Canal Street, was still at odds with HMRC over 2012-13 and 2013-14 liabilities). The addition of a 3.25% interest charge which is more than six times the 0.5% rate that HMRC will pay on refunds looks more like a penalty than commercial restitution.

When the Office of Tax Simplification was set up in 2010, the tension between the simplicity of clear boundaries versus the occasional harsh results caused to those at the margins was highlighted. But currently those at the margins lack certainty. Depending on what they decide to do, they have the prospect of either paying too much in NICs or the risk of a costly and distracting dispute with HMRC at some time in the future. But only if their decision is challenged. The public sector IR35 rules of 2018 and the large employer rules in 2020 are because HMRC is not only aware that many contractors whose status is not even grey were willing to take the risk of not being identified or successfully challenged by HMRC but were succeeding in this non-compliant strategy.

There is a view that aspects of life that are only encountered as adults, such as speeding and paying tax, are where an individual's sense of right and wrong can be less developed. The contractor who says 'I must be self-employed because my agency found me three different interim roles filling-in for employees this year' would be horrified if it was suggested that she should shop lift when there was no chance of being caught. If HMRC has no prospect of having the funds to police the system adequately, then the system needs to be built without room for doubt.

Of course, even with a SET, the categorisation can be ignored or the facts mis-stated. But that is different from being left in limbo having used the CEST tool.

Taking the opportunity to adopt the Taylor review proposals and create a category of dependent contractor would avoid some of the problems of those who now fall at the margins. Such workers can need to travel long distances because their clients are scattered around the country and/or stay away from home for part of the week, so might they receive a measure of tax relief for the necessary costs incurred in the way in which they earn their taxable income? The impermanence of their engagements resulting in a lack of employment law protection as well as uncertainty as to their future income need to be factored into the position. The current IR35 rules mean that contractors whose work results in the Treasury receiving the same tax and NICs as employees are in a worse position when it comes to employment rights. The considerable premium that their services command compensates in part for this, but is it correct that the end client should effectively be able to buy its way out of employment law obligations? Are there protections that money should not be allowed to buy out?

This is a vast area that has impacts across several government departments and it will need a powerful political champion to persuade them to work together. In the meantime, both the tax system and employment law are not fit for purpose; not only in relation to off-payroll working and status determinations for those able to plan their working arrangements but also for the vulnerable worker who is told how it will be by the person who pays them.