Simpler Status

Employment Tax | OMB | Personal tax



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John Whiting looks at the OTS *Employment Status Report* and ponders the future

Key Points

What is the issue?

Employment status is an issue that causes problems for many businesses – but there are no easy solutions

What does it mean for me?

The OTS has suggested a range of routes to explore to improve the position, both direct and indirect, but these will take time and will be one of the issues in ministers' in-trays

What can I take away?

Ideally any solutions would apply across the board – to employment rights and other matters rather than just tax. Meanwhile, the OTS is back, with its role and capacity to be expanded

Readers will recall that the Office of Tax Simplification (OTS) was set up by the coalition government. Our mandate, therefore, expired at the general election in May, although Conservative and Labour manifestos were committed to retaining or even expanding it. This article discusses the final project of our previous existence, the *Employment Status Report*, and OTS expansion.

Why employment status?

Employment status (ES) was identified as an area of difficulty in the tax system in several of our earlier projects. ES is a subject that all our stakeholders – businesses, individuals, agents, academics, HMRC and HMT – wish to be addressed. But our study also attracted interest from wider groups, including the Department for Business, Innovation and Skills (BIS).

Many said that ES had no real solution – though if we did 'solve' it, we should immediately move on to world peace as we would clearly be on a roll. We went into the project not to look for quick answers – rather to survey the area, codify the problems and develop possible routes to improvement. This was always going to be a matter for the new government to take forward. We definitely did not expect, or indeed want, any quick changes rushed through. We wanted to stimulate debate on how the issues should be tackled– and I hope this article will prompt thoughts from readers on how things should be taken forward.

Is there a problem?

All will agree that ES is a real area of difficulty and that such difficulties handicap and distract many businesses and individuals. We think it is a growing problem, though perhaps not as fast as it has been, and that a key issue for businesses and individuals affected is the lack of certainty. Examining the underlying factors led us to the following:

- changing work patterns;
- a desire for flexibility – both from businesses (for their workforce; also simply managing numbers) and from individuals (as a way of working);
- for business, managing the risks involved, both tax exposure and (probably more significantly) exposure to claims for employment rights;
- the lower tax cost of self-employment (mainly NICs, but also expenses); and
- administrative burdens of employing people.

The assumption may be that NICs saving was the main factor. Undoubtedly it was significant for many individuals, but businesses' main concern was clarity on employment rights. For them, their key factor was risk management – the solution usually being only to engage people, if they were not on the payroll, through an intermediary entity such as a personal service company, agency or umbrella. All parties – including HMRC – find the rules difficult to manage, particularly with the way employment case law continues to evolve.

In developing our ideas – which drew on more than 70 meetings, many submissions and 340 responses to our online survey – we kept returning to three key points:

1. The tax (mainly NICs) differential between employees and the self-employed is significant.
2. Employee rights are often of greatest significance to business.
3. The blurred dividing line for employment status causes uncertainty and can make 'gaming' the rules attractive.

Lessons from abroad

Our research showed that all countries have the ES issue to an extent – and that not one has found a perfect solution. Some countries, for example Canada and Brazil, have relatively minor differences in the tax and social security impacts on the employed as against the self-employed. Although they have no clear and simple dividing line between the two employment statuses, they do not have a significant

tax-driven problem.

Four of the most interesting practices adopted elsewhere are:

- US: there is a definition of employed status, known as the ‘ABC’ test;
- Irish Republic: greater use of withholding taxes from the non-employed;
- Australia: the 80/20 rule helps decide on employment status; and
- Germany: an elective system allows individuals to opt for which status.

Improving the position

There seem to be two responses. The straightforward one is to improve the current rules, perhaps by better defining employment status. It is also possible to take the pressure off the issue by adopting indirect solutions.

It must be stressed that we have found no easy or immediate solutions. Most of the ideas we raise would entail significant change, requiring careful consideration and a further, full and lengthy consultation. We are always conscious that change itself is a complication rather than a simplification, though the aim is always for a simpler end point.

Direct routes

HMRC’s guidance and procedures in the ES arena could and should be improved – taking time and effort – but could be committed to quickly. In summary:

- better guidance for those who need to resolve an employment status issue;
- a route for those with a genuine difficulty to talk to an expert quickly and get a ruling – though that raises the question of how to manage demand as well as guard against abuse; and
- developing rules for an evidenced audit trail lending certainty and protection against reopening of previous years.

The online employment status indicator tool (ESI) attracted mixed views. Some use it regularly; others have little time for it, seeing it as biased. Some had not even come across it. We see potential for the ESI being developed, possibly into more than one system to cater for different industry sectors. Ideally this would bring rules for what has to be done and evidenced so that the answer that comes out of the enhanced ESI can be relied on to give certainty.

We regularly heard calls for HMRC to better enforce the rules. People cited examples of practices that are not in line with employment status rules becoming established in industries. Although these can help administration and deliver certainty – two of the OTS's objectives – the objections were about fairness to those not benefiting from what were seen as reduced tax bills. At times, these concerns were often linked to a loss of employee rights for those affected.

Similarly, some occupations have established agreements or rules that need to be revisited to ensure that they remain fair. Separately, there are still some NIC categorisation regulations that can result in NIC treatments differing from income tax. We are unconvinced these are valid. There should be an evaluation with a view to their abolition, although we acknowledge that they are well established and understood, so those affected do get certainty.

Ideally, expenses rules should be reviewed to try to even up treatment. The existing Treasury consultation about travel and subsistence rules for employees, stemming from the OTS report, may help.

Whose job is it anyway?

An interesting theme in many meetings concerned whose responsibility it was to prove the employment status of an individual. The main onus, and risk of penalty, is on the business, which explains the tendency to 'solve' the situation by hiring only through an intermediary. We acknowledge that there is a risk in some of our recommendations that the onus moves to HMRC too readily – that would need managing. But we think more responsibility should be placed on the individual. This has obvious risks – in many situations the individual would not be equipped to decide, but that emphasises the need for better guidance and a route to a ruling that can be relied on. It also makes a system that has a default result more attractive.

Many businesses would benefit from a set *de minimis* level. Someone paid under a set amount or working for less than a defined period would never be an employee, with only a reporting obligation for the hirer. There are risks, such as unscrupulous employers forcing employees to take a succession of *de minimis* roles, but it is worth exploring.

When we began examining ES, we did not think that a statutory employment test would be popular. But there have been numerous calls for exploring the idea, which we endorse. We recognise the difficulties in expressing employment status as a set of rules, but there are clear attractions. Two possible approaches follow:

- a detailed, complex exposition aiming to reflect all relevant case law; or
- a simple or pragmatic set of rules, but which may not be perfect (as used in Australia).

Indirect routes

An indirect route that could help is to introduce a withholding tax in some situations, as is practised in the Irish Republic. This would not just be an enlarging of the construction industry scheme, but a deduction of tax (perhaps at a fixed proportion – say 75% – of the basic rate of income tax) at source from payments where employment status is in doubt. It would not affect those who are clearly employees; similarly it need not affect those whose self-employment status is clear. But it could offer protection for businesses against unexpected liabilities. Although immediate cash flow for some individuals may be disrupted, it might help in tax bill budgeting. It would also place demands on HMRC's IT system to tie up payments and credit taxpayers appropriately.

We have also examined the idea of a 'third way' – an intermediate status between employed and self-employed. There are possibilities in this route, but there are also problems, mainly around the complexity of introducing a further set of rules and policing them. Overall we are not recommending it as a way forward but we do not dismiss it.

The NIC elephant

If progress is to be made in solving employment status as an issue, it is difficult to see how this can be achieved without tackling NICs – the differences between NICs and income tax, and the differing NIC rates. The OTS has recommended the integration of income tax and NICs in a number of its reports and it does so again. The starting point should be to even up NICs, and consequent benefits entitlement, between employment and self-employment (ignoring employer NICs at this stage).

But employer NICs is the real ‘elephant in the room’. This will not be easy, given how much it raises, but it is key to solving the employment status issue. Tackle it and many of the problems go away – though differences around employment rights will remain. We have some ideas for progress in this area, but the starting point is more honesty and transparency about the levy. If more people realised how much it cost and raised, would there be more support for a renewed look at how to raise this money?

Taking things forward

The overriding aim must be to develop ideas that lead to simpler rules that can be readily applied in practice and are easy to enforce – that is the call we have heard all the time.

A lot of the support we found for exploring ideas such as a statutory test was predicated on applying rules across the board. Employment status affects issues beyond tax – including employee rights, national minimum wage, benefits and credits, and pensions auto-enrolment (a significant new factor in the minds of many businesses). The ultimate simplification goal would be a set of rules and practices that applies to all these areas. That will be difficult. Employment rights follow from employment law and are outside the control of the tax authorities. But there would be huge benefits in harmonised rules and the possibilities need to be explored with government departments beyond the Treasury and HMRC.

OTS reborn

What next for the OTS?

I have always said that the OTS was an experiment to see whether it was worth trying to simplify our over-complex tax system.

During our first five years we produced 33 reports and papers in 10 project areas; we put forward 402 recommendations and, so far, have seen half of them taken forward in whole or in part. That is not a bad success rate and the modest size of our budget (£1.7 million over the five years) suggests we are value for money and a catalyst for improvement.

At the same time I do not in any sense suggest the OTS has been perfect. But we have learned as we have gone along and developed an effective way of working,

founded on wide-ranging evidence-gathering.

Recommendations are evidence based, proven to be practical and worthwhile. So, we think we have earned the right to continue – and to be trusted a bit more readily, by having our recommendations accepted as properly made and not needing to be reworked.

It is therefore welcome that there is a Conservative manifesto commitment to ‘establish the OTS on a permanent basis and expand its role and capacity’. We have ideas about how that should be effected, including a formal reporting line to parliament. Naturally, we want more staff. Not a huge number more, but enough to ensure our work is evidence-gathered, not just office-based thinking.

We should be given a brief to examine new law, such as the Finance Bill, not just what is on the statute book. Should we publish an annual simplification report on how the tax system has changed in the year under review?

It would be productive if we were given the brief to develop some of our major ideas more fully, such as income tax/NIC combination, the statutory employment test or wider withholding tax.

The stance would be that we have convinced government ministers that the ideas have merit but that more work is needed. We would look at costs, winners and losers; how the change would be made and the transitional issues in order to develop something of a green paper.

One thing is clear: we have not finished! We will never get to a simple tax system for the UK; that is surely out of our grasp. But it should not prevent us trying to develop a simpler tax system to benefit all taxpayers, agents and authorities.

Therefore, let us know what you think we should do next at ots@ots.gsi.gov.uk