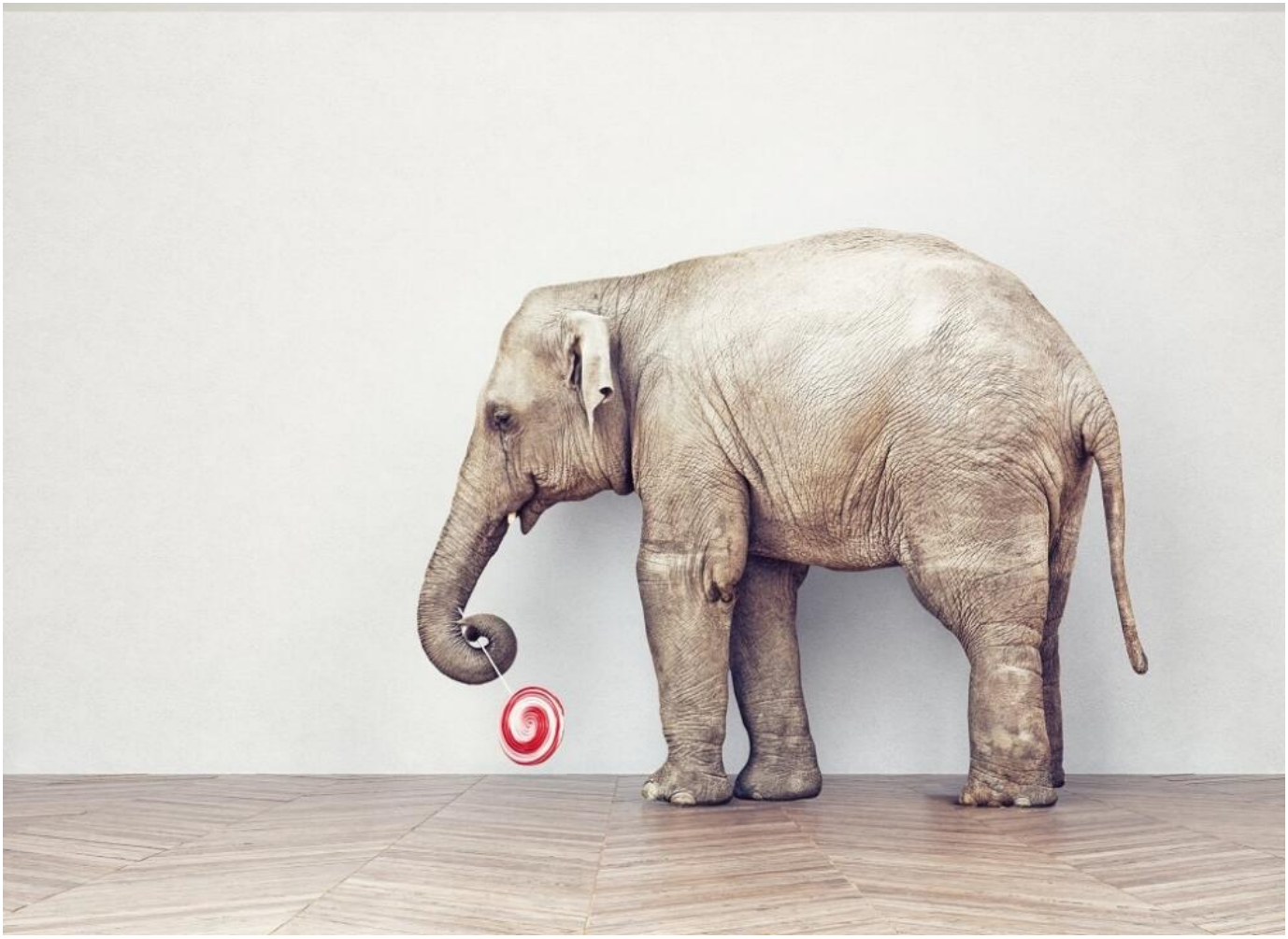
# The elephant in the room

Employment Tax



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*Michael Steed* wonders if the time has come to rip up the rule book for NICs in respect of employment status

## Key Points

## What is the issue?

We have a distorted and arguably outdated NIC landscape in the UK that is no longer fit for purpose and here we consider what might be done about it.

## What does it mean to me?

That advising in this uneven landscape is notoriously difficult with a tripartite employment law and a bipartite tax and NIC employment status classification.

## What can I take away?

That re-forging the NIC rules would make them more in line with modern working practices and employment law definitions, but that this would introduce other knock-on effects that would need to be considered.

This article is a thought piece that addresses the difficult relationship between employment law and tax/NICs in the light of the slew of employment law cases, which have firmly confirmed the newer ‘worker’ status for employment law (I will refer to that status as the ‘dependent contractor’ in this article).

The elephant in the room is increasingly NIC status and its inflexibility is arguably a hindrance in trying to solve this relationship in a modern world with changing work practices.

The press has been full of cases about employment status in the last couple of years. But this is not an article per se about employment status. This is an article about how this rapidly developing area of employment law affects tax and NIC status and how as advisers we have to deal with a tripartite system for employment law and a bipartite system for tax/NICs.

The Taylor review of modern working practices in 2017 favoured the three-tiered employment law categorisation – employee, worker, self-employed contractor, although it found the word ‘worker’ confusing and proposed that those with worker status should be reclassified as ‘dependent contractors’ and urged the government to identify a clearer distinction between an employee and a ‘dependent contractor’.

The review went further, suggesting that the distinctions drawn in tax and employment law should be aligned. The government responded to the review and consulted on a number of recommendations.

The Government issued an Employment Status Consultation in February 2018. Both the CIOT and the ATT responded to it and made wide-ranging comments, most of which were in respect of the outdated bipartite tax treatment between employment and self-employment and the difficulties of having such a stubborn boundary that tempts people to game the system for advantage.

I have taken a couple of points from the responses which I think captures the essence of the issue.

The CIOT commented (inter alia) as follows: ‘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%. 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’.

The CIOT also said: ‘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.’

The ATT also commented (inter alia) as follows: ‘A broader review could also consider if introducing a third category for tax for the dependent contractors identified in the original Taylor report might help to reduce the distortion by providing another rate between the two positions and, equally, ensure that the number of categories of employment status match the three legal positions of employee, Limb (b) worker and self-employed’.

The essence of this suggestion is to consider having the ‘dependent contractor’ status for tax/NICs too, with its own NIC rates for both the engager and the dependent contractor

It’s this bit that I’d like to examine in this thought piece – and to address the issues surrounding the elephant in the room – not tax, but NIC contributions – and the distortion that the bipartite employer/employee system maintains. All categories pay tax at the normal rates in the appropriate bands. The NICs are glaringly different.

The employee/self-employed distinction for NICs, simply put, is outdated; it belongs to an older world where the majority of the workforce were employees.

The Gig economy with its more flexible working has also shone a spotlight on the issue and case law has said that this inflexibility should be remodelled for employment rights, so why not for tax?

## The use of CEST

CEST is a voluntary online tax tool that helps people determine tax status in a variety of situations. This is the latest incarnation of a tax status determination tool that is available to taxpayers and is meant to be used to find out whether a worker is employed or self-employed for tax purposes for a particular engagement.

It has come in for a fair amount of criticism, not least from the BBC in respect of their entertainers. Lord Hall recently gave evidence to the Parliamentary Public Accounts Committee saying that the introduction of CEST in 2017 had led to a major change in emphasis in employment status particularly in respect of IR35.

I have commented before on IR35 status (TA – July 2018 – No Single Key) and the latest IR35 case just handed down (*Lorraine Kelly in Albatel v HMRC* [2019] UKFTT 0195 (TC)), highlights the complexity of the area and that simple A or B outcomes are often not possible with an online tool. Real life is more textured and subtle and Tribunals are ever ready to explore that complexity.

In the context of this thought piece, its use at the moment maintains the bipartite tax/NICs system and if thought was given to changing to a tripartite system, then it is self-evident that the CEST tool would need to be adapted. CEST is particularly in point in the context of extending IR35 into the private sector in 2020.

## So where are we so far?

Now to the nub of the matter. If we have such a discrepancy between tax/NICs and employment law, then what could we do about it?
We may conclude that the discrepancy needs to be left alone as the two systems (employment law and tax/NICs) are trying to do different things.

As an alternative, we may conclude that we do need to address the issue, particularly in respect of the elephant in the room – NICs classes and contributions, although we would have to look at the knock-on effects (considered briefly below).

## So let’s dream a while…

Suppose we accept that the employment law three-box system is broadly settled; dare we map that across to the tax/NICs system and see what it might produce?

The essence of this suggestion is to consider having the ‘dependent contractor’ status for tax/NICs too, with its own NIC rates for both the engager and the dependent contractor.

So here is my Aunt Sally and in it, let’s park the revenue-raising issue for a moment and look at the problem through the twin lenses of clarity and equity.

How about a new NIC class for the dependent contractor of say 9% on the individual contractor (contributory) and a new NICs rate of say 9% on the engager (I am not wedded to these precise numbers, but I am using them to illustrate the principle).

If we went the whole hog, we might consider making the system more balanced and reduce the Employers’ rate for NIC (Class 1 secondary) to say 9% too (like I said, I am not considering the revenue-raising issues here).

Under this Aunt Sally, the idea would be to leave Class 4 alone for genuinely self-employed taxpayers. Philip Hammond unsuccessfully tried to raise Class 4 NICs in 2017 (which were due to rise from 9% to 10% in April 2018 and to 11% in 2019) to narrow the gap between self-employed people and employees (at the centre of this rapid U-turn was a political issue – that of Conservative Election manifestos not to increase tax rates).

The above suggestion is bold and would need a majority government and it’s not for the faint hearted, but it’s arguably fairer and clearer.

## Other related tax issues

Nothing happens in isolation in tax and to complete this thought piece, we’d need to look at some other related issues. These would include:

- If the government did go for a dependent contractor NICs class, would it also need to consider collection mechanisms? The OTS in its March 2015 Employment Status Report commented on collection mechanisms, including a quasi CIS system of tax deduction as an alternative to using PAYE and concluded that such an idea had merits. Within the scope of this thought piece, we would need to consider whether that extended to NICs too.

- Would a dependent contractor need to complete an SA return and what expenses would such a dependent contractor be able to deduct from profits/earnings? A clear set of deduction rules would be needed, especially for travel and subsistence costs.
- What about VAT? – one idea would be to make a dependent contractor's services outside the scope of VAT for simplicity and this would distinguish the dependent contractor from a genuinely self-employed contractor, but there would be adverse revenue effects (although not considered here).

## Conclusion

There is much to play for here and settling the 'three into two won't go' issue is at the heart of aligning employment law and the tax/NICs landscape. This thought piece at least tries to deal with the cliff-edge issues in a bipartite system, but acknowledges that the knock-on effects would have to be addressed too.