Negotiating the statutory maze governing employment status

Employment Tax | Personal tax



22 April 2022

We must find some clear routes through the statutory maze governing employment status.

The key components of a tax system are law enacted by a democratic parliament; collection and enforcement by an independent tax authority; and adjudication of disputes by an independent judiciary.

Complexity can show up in every element of this virtuous triumvirate. The tax policy and enabling legislation may be unclear, or not suited to the broad structure of the existing tax system. The tax authority might have complicated administrative processes, or a lack of straightforward guidance to help taxpayers and their advisers (and indeed the tax authority's own officers). A further sign of complexity in the tax system is an over-abundance of tax cases in a specific area. Tax cases mean that either the law itself, or the application of the law to a wide range of potential facts, is not clear.

The impact of complexity is likely to be felt in increased costs, uncertainty and a lack of understanding of how tax affects a business or family transaction or activity. Litigation places a great burden on taxpayers, as it is expensive and very time-consuming – and the result often takes a decade or so to become final.

The problem of definition

The area where we see most tax cases concerns whether someone is providing services as a quasi-employee or as a self-employed person. We can all see that the state of the law is unsatisfactory, as so many people, including well-known individuals, find that their status is challenged by HMRC. Of course, the key reason why so many cases arise is because self-employed individuals have a much lower tax burden than employees. Typically, the biggest difference is national insurance, where employers pay directly 15.05% and the employee's rate is 3% higher than for a self-employed person.

The debates in this area revolve around principles originally set out in 1967 by Mr Justice MacKenna in the *Ready Mixed Concrete* case, which interestingly involved the change of status of an employee to a self-employed person – rather as we see in more modern cases. The concrete company sold the individual the truck he drove under hire purchase and paid him a rate per job, with a minimum overall income. The Ministry of Pensions argued that he was an employee but the judge disagreed, holding that the individual was 'a "small business man" and not a servant'. The tests used look at the right of substitution, control and mutuality of obligations.

These rules are unclear. HMRC has put forward some help in the form of the Check Employment Status for Tax tool (CEST). The Department acknowledges that the tool cannot provide clear answers in a minority of cases (see bit.ly/3EwNm4k), and usage data shows that the status cannot be determined in about 20% of cases.

Potential solutions

How might this area be taken forward? There are two issues: the legal question of whether someone is an employee for tax purposes; and the economic issue of the overall tax and national insurance costs.

Surely the answer to the legal question is to develop a new statutory test of employment? The precedent is the statutory test of residence, where new principles

were developed to define residence. The key point of the statutory test is that it did not attempt to codify principles drawn from tax cases. Rather, it asked what should be the key factors determining residence. The resulting test is complicated to apply in some cases, but it has the significant benefit of providing a clear answer. Could we not adopt the same approach and develop a new test for employment – at least for tax purposes?

There are two other important areas aligned to this issue. How should status for employment law be determined? Given that there are three status levels for employment law, but only two for tax and national insurance law, how should we deal with overlap? Litigation clearly gives rise to unintended consequences in this area, where cases involve individuals seeking additional employment law rights beyond those originally part of the initial contract between the engager and the individual. Getting it wrong means large backdated claims.

The biggest issue of all, though, is the economic difference between engaging an employee and engaging a self-employed person. Unless this is tackled, there will continue to be pressure on the boundary. Perhaps there are two possible routes: adding an engager levy, where an engager benefits from the services of a self-employed person; or substantially increasing the national insurance payable by the self-employed. The engager levy has the merit of applying to freelancer type of arrangements and – like employer national insurance – appears to be payable by the engager. It has the challenge of finding an acceptable and workable definition. Both routes involve significant economic changes which would not be easy to implement. However, as *Ready Mixed Concrete* shows, the issue has been with us for a very long time and is only like to grow in importance with new ways of working.