Smile Care South: the complexities of tax and legal status

Employment Tax

20 November 2023

The case of *Smile Care South* highlights the complexities of tax and employment legal status, and the impact of the difference between them.

Key Points

What is the issue?

Under employment law, there are three status categories: employee, worker and self-employed. In contrast, tax only recognises two categories: employed and self-employed.

What does it mean for me?

A recent judicial ruling involving a dentist provided a stark reminder of the difference between the legal and tax assessments for employment status, and why

it is important to consider both perspectives.

What can I take away?

The challenge for businesses is that status cases are based on an assessment of the facts of the particular case, and that means each arrangement should be considered on its own merits.

Under employment law, there are three status categories: employee, worker and self-employed. Employees and workers are entitled to rights such as the National Minimum Wage, holiday pay and pension auto-enrolment. Employees are also entitled not to be unfairly dismissed, and to statutory redundancy pay after two years' continuous service.

In contrast, tax only recognises two categories: employed and self-employed. There is no recognised definition of a worker. This can often create a diversion in outcomes of the assessments for tax and legal status.

The government consulted over the proposal to align the status tests, but in 2022 concluded that there was no need to introduce any changes at the present time. That was seen by many as a missed opportunity to bring some much needed simplification to the assessment for both employers/engagers and those working for them.

In a recent judicial ruling involving a dentist, the Employment Tribunal provided a stark reminder of the difference between the legal and tax assessments for employment status, and why it is important for employers and their professional advisers to consider both perspectives. In this article, we examine that case and revisit the critical factors in ascertaining an individual's employment status. We also explore the disparities that arise between the status assessments conducted by HMRC and the Employment Tribunal, and the broader implications for regulatory compliance.

Interestingly, the employment status of dental associates has specifically been discussed many times in recent years. Up until 6 April 2023, for tax purposes dentists had been covered by HMRC guidance that stated:

> ‘It should be noted that there are standard forms of agreement for “associate” dentists which have been approved by the British Dental Association (BDA) and the Dental Practitioners Association (DPA). These agreements relate to dentists practising as associates in premises run by another dentist. Where these agreements are used and the terms are followed, the income of the associate dentist is assessable under trading income rules and not as employment income. In these circumstances the dentist is liable for Class 2/4 NICs and not Class 1 NICs.’

However, following a review, HMRC withdrew its guidance, so dental practices and associates will now be required to consider the tax status of all new dentists. They should also have assessed, ongoing dental associate agreements on a case-by-case basis in line with the HMRC Employment Status Manual ESM0500.

Self-employed dentist claims holiday pay and pension auto-enrolment

The case of *Dr M Henry v Smile Care South Ltd and others* (3200328/2023) concerned a dentist who was working as a self-employed contractor with Smile Care South (Smile). The contract between the parties made it clear the dentist was self-employed and stated that ‘nothing within it shall constitute a partnership or a contract of employment’.

The relationship became fractious, however, when Smile sought to relocate the dentist from London to Norwich, where a new dental practice had recently opened. The dentist voiced his opposition to this proposed relocation, and his contract was subsequently terminated by Smile.

In response, the dentist initiated an Employment Tribunal claim, alleging that he was a worker, and therefore was owed money for unpaid pension contributions and holiday pay which had accrued during his engagement. At the Employment Tribunal, he succeeded with his claim that he was a worker.

Employment status is a multifactorial assessment

Assessing an individual's employment status for both tax and legal rights requires a consideration of many factors, which include:

- the existence of a contract (whether or not it is in writing) between the individual and the employer to perform services;
- whether the individual is personally required to perform the services – the requirement for personal service is often analysed through the lens of whether the individual has the unfettered right to appoint a substitute;
- a minimum degree of commitment on both sides, stipulating an obligation on the business to provide work, and the individual to perform the work – commonly referred to as a 'mutuality of obligation';
- supervision, direction or control over how, where and when the work is performed;
- whether the individual operates independently and shares financial risk in the performance of the work;
- whether they are supplied with tools and equipment to do the work; and
- their integration into the business (for example, the requirement to wear branded uniform or have a company email address).

Both the terms of the contract and the reality of what happens in practice must be considered together when carrying out the assessment. It is worth noting that a conditional right to provide a substitute may or may not be consistent with personal service; it will depend on the precise contractual terms, and the degree to which the right is limited or occasional.

Employers have the option to include a 'substitution' clause in the contract, stipulating that the individual has the right to designate a substitute to perform the work. However, for this clause to carry weight in the eyes of the tribunal, it must be convincingly demonstrated as a bona fide provision, and the individual must have the practical ability to appoint a substitute when necessary.

The assessments differ, however, as the starting point for employment legal rights is to consider the purpose of the legislation, which is the protection of individuals subordinate to another party. They are about ensuring that potentially vulnerable

workers, who are subordinates and lack bargaining power, can't have rights withheld.

This route is not available in tax cases, as confirmed in *HMRC v Atholl House Productions Ltd* [2022] EWCA Civ 501 in April 2022. The Court of Appeal established important points of principle for tax, drawn from *Ready Mixed Concrete (South-East) Ltd v Minister for Pensions* [1968] 2 QB 497 ('*RMC*'). *RMC* describes key areas to be considered, including personal service, mutuality of obligation, control and then 'other factors'. Other factors help to establish whether there is anything that might differ from the conclusion drawn after personal service, mutuality and control are considered, such as being 'in business on own account'.

Control and subordinate relationship

The contrast in outcomes is evident in the case of *Smile Care South*. HMRC had already concluded that Dr Henry was self-employed for tax purposes; however, the Employment Tribunal concluded the dentist was a worker.

When considering both the terms of the contract and the reality of the relationship, and looking at the purpose of the legislation, the tribunal concluded the dentist was under the control and in a subordinate relationship to Smile. Key factors it relied on when reaching this conclusion are set out below:

1. **Direction, control and supervision:** The dentist, Dr Henry, was under the direction, control and supervision of Smile. He was obliged under the contract for the dentist to undergo a supervised training period to practice dentistry with Smile. He could only offer services when the Smile practice was open. He had no power to remove a mobility clause in his contract, despite being unhappy with it.
2. **Service:** In practice, the dentist was unable to provide a service thereby necessitating personal service.
3. **Integration:** The dentist was deeply integrated into and reliant on Smile's operations. All administrative aspects related to patient treatments were managed by Smile. Access to patients was entirely facilitated by Smile, which presented Dr Henry to patients as an integral member of their team. Any

correspondence between the dentist and the patients was headed ‘Smile Dental Care’ and his business cards carried the Smile logo. Whilst the uniform he wore to work was not branded, it was near identical to the uniform worn by Smile employees.

4. **Mutuality of obligation:** There was a degree of mutuality of obligation – the dentist did not refuse assignments from Smile.
5. **Status:** The dentist was not in business on his own account, as he did not retain patients after the engagement with Smile concluded.

As a consequence, the tribunal found that the dentist should be entitled to compensation for any unpaid holiday pay and employer pension contributions that he should have been entitled to during his engagement with Smile.

Regulatory implications

The challenge for businesses is that status cases are based on an assessment of the facts of the particular case, and that means each arrangement should be considered on its own merits. Added to this complexity is the different outcomes which can be reached by HMRC and the Employment Tribunal, as demonstrated in this case.

Historically, businesses might have worried more about a HMRC challenge, as this can often impact more than one individual and result in outstanding tax and NICs assessments covering up to six years. This was often seen as the highest cost of getting the wrong answer (despite perhaps a set off of any tax already paid due to the NICs costs).

This resulted in some businesses stopping at a conclusion that an individual is self-employed for tax purposes, and not worrying about the employment legal position (as this was more likely to be challenged by one individual). However, businesses should undertake a separate employment legal rights assessment, given the different principles that apply to the test, and the fact that that the Unions and Pensions Regulator have this within their sights. This is particularly the case where the assessment has included pointers towards employment and self-employment, as worker status can be said to be the middle ground. Alongside the tax and NICs risk, businesses should consider the exposure to the costs of litigation as was the case in

Smile Care South.

Secondly, there will be the liability for unpaid holiday pay, which the Supreme Court has recently confirmed can go back up to two years (and further in Northern Ireland).

Finally, there is also regulatory enforcement from the likes of the Pensions Regulator, which enforces compliance with pension auto-enrolment. The misclassification of an individual as self-employed has ramifications regarding pension contributions. When individuals are wrongly classified as self-employed, they are not auto-enrolled into qualifying pension schemes. Consequently, the Pensions Regulator has the power to mandate employers to auto-enroll such individuals into a qualifying pension scheme and backdate the missed employer pension contributions to the point at which the individual should have originally been auto-enrolled. In some cases, the Pensions Regulator can also enforce employers to reimburse the missed employee pension contributions too.

Conclusion

The *Smile Care South* case serves as a notable example of the differing outcomes which can emerge between legal and tax assessments of status categorisation.

The far-reaching implications of an incorrect assessment underscores the necessity for employers to diligently assess the employment status of their workforce. Regulators are increasingly vigilant in enforcing compliance with pension auto-enrolment regulations and holding employers accountable for misclassifications.

One can’t help but think the government has missed an opportunity to simplify this issue and create more certainty for business and individuals over their obligations and entitlements.