AN IER SUBMISSION

In response to a Call for evidence from:

HOUSE OF LORDS ECONOMICS AFFAIRS COMMITTEE

FINANCE BILL SUB-COMMITTEE

WRITTEN EVIDENCE FROM
INSTITUTE OF EMPLOYMENT RIGHTS
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Introduction

1. This is the written evidence from the Institute of Employment Rights ('IER'), which Mr Hudson kindly invited us to submit to the Finance Bill Sub-Committee in an e-mail of 24 February 2020.

2. The IER is a think tank for the trade union movement and a registered charity. Established in 1989, it provides information, written analysis and policy contributions from academics, researchers and lawyers. It has often contributed to public consultations in the past - for example, on the issue of tribunal fees and reform of employment tribunals.

3. **Summary**. These submissions are principally directed to questions 6 to 12 of the Committee's areas of interest. The IER's central points are the following:

   a. The provisions of the Finance Bill are built on a legal concept which is uncertain in its application – the common law contract of service. The use of the hypothetical contract in the IR35 legislation adds another layer of legal uncertainty.

   b. Careful drafting of contracts or the interposition of intermediaries can often defeat the existence of a contract of employment, hypothetical or actual. The changes in the Finance Bill risk adding to the legal incentives on employers to structure relationships so as to avoid both tax responsibilities and employment duties. In this way, the provisions may undermine the aims of both fiscal and employment rights legislation.

   c. The objective which underpins the Bill is tax neutrality or fairness. But it is not fair that those who are in a *de facto* employment relationship should be taxed as such but not receive any employment rights. Given that the use of intermediaries is often a condition of employment for those who are effectively employees or workers in all but name, and given that the new tax rules eliminate any trade off between tax and employment rights, it is only fair that those who are taxed as employees receive the same rights. Otherwise, the incentives to adopt structures which generate the very problems the Bill is meant to solve

will remain.

d. At present, the reliance of both tax and employment law on a bilateral contract for personal service means that both are vulnerable to structuring relationships to avoid the duties. It is time to cut this particular Gordian knot by adopting a different model, of an employment relationship based on the *fact* an engagement for the provision of labour by those who are not genuinely running their own business.

4. This document draws extensively on an article written by Professor Michael Ford QC, of the University of Bristol, for the Industrial Law Journal: 'The Fissured Worker: Personal Service and Employment Rights'. The article is available on-line[1] and contains details of the background to IR35, evidence about its empirical effects and the problems the tax environment causes for employment rights. The Committee may find it useful for the general context of the legislation as well as for some of the policy issues it generates in relation to employment rights.

Determining Tax Status of Workers

5. **Question 6.** The IER is concerned about the difficulty of applying the IR35 legislation to decide which individuals are hypothetical employees. This issue goes beyond the extension of the existing rules for public authorities in Chapter 8 of the Income Tax (Earnings and Pensions) Act 2003 ('ITEPA') to private employers. It is part of the continued difficulties for policy caused by not treating issues of tax together with questions about employment rights.

6. There are three specific problems. The first is the lack of clarity in the test for establishing whether an individual is an employee. The hypothetical contract in s.49 of ITEPA continues to draw on the existing common law rules for establishing whether someone is an 'employee': see s.4 ITEPA. The uncertainty in the common law concept has already been highlighted by the Taylor Review.[2] Recent cases on substitution clauses highlight the very fine lines to be drawn in this area, and demonstrate how carefully drawn contracts can still defeat employment or worker status.[3]

7. Second, the hypothetical contract adds to this uncertainty, especially where intermediaries are involved – as they often are. Deciding what terms the parties would have agreed, based on the factual arrangements and their

[1] https://academic.oup.com/ilj/advance-article-abstract/doi/10.1093/indlaw/dwz022/5686807?redirectedFrom=fulltext.

[2] *Employment Status Consultation* (February 2018), 46-7 <https://www.gov.uk/government/consultations/employment-status > (accessed 16 September 2019).

[3] See e.g. the case involving Deliveroo cyclists: *R (IWGB) v CAC and Roofoods* [2019] IRLR 249, currently the subject of an appeal.

interaction with the express terms of often more than one contract, and then ascertaining whether those hypothetical terms would amount to a contract of requires some mental gymnastics.[4] It undermines legal certainty for everyone except those with access to expert legal advice.

8. Third, the failure to treat tax together with employment rights issues risks producing unintended consequences. Employers continue to have incentives to draft contracts and structure relationships to take individuals outside of the protection of employment rights. At the same time, the tax system provides incentives to achieve the same goal. The growing use of substitution clauses, which have the magical effect of denying employee and worker status, can no doubt be traced back to these twin objectives. The more the law continues to be based on analyzing the terms of the contract to determine the individual's employment status, the greater the damage to both employment protection *and* to fiscal targets.

9. The IER suggests it is time to cut through the bewildering array of tests have to be applied to determine the tax and employment rights of individuals. The legislation on employment rights already adopts several concepts: employees, who have most rights; workers who have some rights, such as the national minimum wage; and extensions to some other groups of some rights, such as agency workers. Grafted on top of this is now a separate set of legal questions for tax purposes. Although in its response to the Taylor Review, the Government said it would publish 'detailed proposals' on the alignment of employment status for tax and employment purposes, the proposal appears to have stalled.[5] The IER considers it is time for a single concept of worker applying across the board and based on the factual relationship[6] - similar to how the European Court of Justice and the European Court of Human Rights approaches this question, and consistent with the Recommendation of the International Labour Organisation.[7]

10. **Question 7**. The IER is aware that the CEST tool has been much criticized. If the Committee wants evidence of the unreliability of the HMRC's assessments, it need only look to the numerous cases which it has lost on IR35 status.[8]

11. **Question 8**. The IER has no submissions on this question.

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[4] See e.g. *Synaptek v Young* [2003] ICR 1149 [11].

[5] HM Government, *Good Work Plan* (December 2018), 28-9, at <https://www.gov.uk/government/publications/good-work-plan> (accessed 16 September 2019).

[6] K. Ewing, J. Hendy, C. Jones (eds), *Rolling out the Manifesto for Labour Law* (Institute for Employment Rights: 2018), ch 6.

[7] See on this the Fissured Worker article, pp 25-26, 34.

[8] See e.g. *Atholl Productions v HMRC* [2019] UKFTT 242 (Kaye Adams) and *Albatel Limited v HMRC* [2019] UKFTT 195 (Lorraine Kelly).

Policy Objectives and Wider Context

12. **Question 9**. According to the consultation, the objective of the rules is to ensure that those who do the same job as if they were an employee should pay tax at the same rate as an employee.[9] The underlying principle is presumably tax neutrality, that tax should not influence the corporate structure adopted.

13. The legislation achieves this goal by a form of sticking plaster – the hypothetical contract. It ignores the incentives employers have to use intermediaries, including personal service companies ('PSCs'), quite apart from tax reasons. Employers, in particular, may engage people doing the same job as direct employees through intermediaries in order to avoid owing those individuals employment rights. It is no secret that exclusion from employment rights is often a central reason why employing clients or agencies insist on individuals working for them by means of a PSC. For example, see the evidence of Amey plc to the House of Lords Select Committee on PSCs:[10]

> if we need someone for three months or six months and we give them an employment contract, that raises a whole host of issues that are disproportionate to the intended length of the relationship and can include equality of employment rights...

14. Thus, at present, the means of avoiding employment rights helps to generate the very problem which Chapter 8 of ITEPA and the new Finance Bill attempt to solve for fiscal reasons. This once more returns us to the need for joined up thinking on tax and employment rights. A simpler way of ensuring tax neutrality, the IER submits, would be to remove or at least reduce the legal incentives on employers to use intermediaries in the first place – including to avoid employment rights. If an individual who is not genuinely running their own business is engaged by another to supply labour, that individual should benefit from employment/worker rights. Such a measure would help to address the problem before it requires remedial fiscal action.

15. **Question 10**. See above. It is well documented that the existing IR35 legislation, placing liability on the PSC in relation to tax, has been a spectacular failure. The Government's own estimate of 'endemic' non-compliance in the private sector is that it cost £700 million in 2017/18, rising

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[9] HMRC, HM Treasury, *Off-payroll Working in the Private Sector* (18 May 2018), 9, at < <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/708544/Off-payroll_working_in_the_private_sector_-_consultation_document.pdf> (accessed 9 August 2019).

[10] House of Lords Select Committee on PSCs, *Report of Session 2013-14, Personal Service Companies* (Stationery Office, 7 April 2014), 23 <https://publications.parliament.uk/pa/ld201314/ldselect/ldpersonal/160/160.pdf>

to a projected £1.2 billion in 2022/23.[11] In the absence of measures to reduce the incentives to use PSCs and other intermediaries, the fiscal rules will always be vulnerable restructuring of relationships designed to deny dependent labour employment status.

16. **Question 11**. The IER repeats its basic point that legislation should 'see through' the use of intermediaries for a wide range of purposes.

17. **Question 12**. The reforms risk giving rise to more problems in the wider economy, including in relation to 'gig' work. For example, unless the rules on substitution clauses are changed – a recommendation of the Taylor Report - it is predictable that such clauses will become even more common features of contracts for labour, simultaneously achieving the magic of removing all employment rights and tax responsibilities because they prevent individuals being employees or workers. The substitution clauses adopted by Deliveroo in the wake of litigation may well provide a model here. More fundamentally, because of the reliance of both tax law and employment law on (i) a contract (ii) for personal service, the goals of both sets of legislation are vulnerable to the interposition of legal intermediaries or clauses drafted by 'armies of lawyers'. That is why the IER proposes a fundamental break with the test for who is an employee (or worker).

18. Nor is it fair that individuals should pay tax as if they were employees yet receive none of the benefits of employment rights. Chapter 8 of ITEPA does nothing to question the legitimacy of using legal intermediaries, such as PSCs, as a means of an individual providing labour to an organisation. Worse, it has the effect of implicitly *endorsing* their legitimate use for the 'flexible' allocation of labour rights because it does nothing to question the legality of using PSCs.

19. If it is only 'fair' that individuals who look like employees are taxed as such, it is only 'fair' that they are given the same rights as employees. In these circumstances, the argument that lower taxes are a rational trade-off for employment rights has no weight. There are already many examples of individuals who are de facto in a subordinate relationship resembling employment and who are required to provide services via a PSC or other intermediary: see e.g. how the recently defunct City Link engaged many of its drivers.[12] Where the use of intermediaries is frequently imposed as a condition of working, so that any 'choice' is illusory, there can be no justification for excluding those social rights which aim to protect dependent or quasi-dependent labour in the wider public interest. The national minimum wage is the most obvious example (responsibility for which can be eliminated by an effective substitution clause à la Deliveroo).

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[11] See the consultation, n. 9, pp 5, 19.

[12] See the report of BEIS and the Scottish Affairs Committee, Impact of the Closure of City Link on Employment, ch 4, https://www.parliament.uk/closure-city-link-inquiry

20. This again illustrates the importance of treating issues of tax and employment rights together. Otherwise, fiscal goals can undermine employment rights and *vice versa*.

End note

21. The IER is, of course, happy to supplement this note or provide further information if the Committee so wishes. Please contact Carolyn Jones, Director, cad@ier.org.uk. 07941 076245