Employment status and onshore intermediaries

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The proposed measures intended to counter false self-employment look set to be the latest in a long list of botched attempts to tackle an issue which the draftsman seems not to have understood.

The possession by a worker of self-employed status generally gives – in fiscal terms at least – a number of advantages both to him and to his 'engager' (to use a neutral expression). The engager has no obligation to pay employer's national insurance contributions. And the worker himself pays a marginally lower rate of NIC, enjoys a cashflow advantage in consequence of not suffering the deduction of tax and NIC at source, and also enjoys a moderately more generous regime for the deductibility of expenses (when compared with his employed equivalent).

The fiscally privileged status afforded to self-employment – and the narrow dividing line between it and employment – has created a powerful incentive on the part of both workers and engagers to seek to cast the relationship between themselves as one of a contract for services rather than a contract of service. And, over the years, in recognition of engagers' desire for these fiscal consequences without the risks attendant on getting status wrong, a very valuable business has grown up: that of standing between the engager and worker. The business – commonly referred to as an intermediary – contracts with the worker, supplies him to the engager, takes the risk of the worker wrongly being treated as self-employed, and charges a fee to, typically, the engager.

The history

A study of the later Chapters of Part 2 of ITEPA 2003 reveal a close, and longstanding, attention on the part of the draftsman to situations in which the bipartite (engager-worker) relationship becomes a tripartite (engager-intermediary-worker) one.

First, there were the agency provisions, now to be found in ITEPA 2003 Part 2 Chapter 7. These stipulated that, where a worker provided services to an engager through an intermediary (typically an employment agency), his earnings should (subject to certain conditions) be treated as earnings from an employment held with the agency. Broadly, the conditions enacted certain of the common law tests for an employment relationship, but were relatively easy to sidestep – typically, by the introduction of a clause entitling the worker to send in a substitute.

Next came the so-called IR35 provisions, now to be found in ITEPA 2003 Part 2 Chapter 8. In design (although it is less clear that their scope is so limited), they tackled the interposition between worker and engager of a personal service company (PSC) and deemed the payment made to the worker to be a 'deemed employment payment' with corresponding tax and national insurance contributions liabilities. Although conceptually effective, these provisions suffered from problems at the enforcement level. First, it proved difficult for HMRC to police their correct application by the PSC. Second, even where it was discovered that the provisions had not been properly applied, the (typically) thinly capitalised PSC could simply be wound up without its historic tax liabilities having been met.

Third came the so-called managed service company provisions, now in ITEPA 2003 Part 2 Chapter 9. These provisions created a similar type of tax charge to the IR35 provisions but also contained provisions which enabled the tax debt to be collected not merely from the managed service company but also, in certain circumstances, from the 'MSC provider' (broadly, a person who promotes or facilitates the use of companies to provide the services of individuals). Whilst these provisions addressed practical tax collection deficiencies in the IR35 provisions, they were poorly drafted and, it would seem, covered less ground than had at first been anticipated. They also failed to provide any solution to HMRC's difficulties in policing compliance.

There was then, fourth, an attempt on the part of the last Labour government to introduce certain simple tests, on the satisfaction of which a worker would be deemed (for tax purposes) to be an employee. These were ditched following the change of government.

The present proposals

The present proposals – set out in HMRC's consultation paper *Onshore employment intermediaries: false self-employment* – are, in effect, a mixture of the first and the fourth. Broadly, they amend the agency provisions in Part 2 Chapter 7 such that, on the satisfaction of certain conditions, a worker shall be treated as employed for income tax purposes.

More particularly, the status quo ante in Chapter 7 required, materially, first, *the contract between* the worker and the agency to oblige the worker to provide his services personally and, second, a worker to be subject to supervision, direction or control as to the manner in which his services were provided.

The proposed legislation applies where a worker personally provides, or is personally involved in the provision of, services to the client. This requirement will be satisfied even where, contrary to the status quo ante, the contract entitles the worker to send in a substitute. However, as with the status quo ante, the proposed legislation continues not to apply where the manner in which the worker provides the services (or the manner of his involvement in the provision of services) is not subject to (or to the right of) supervision, direction or control by any person (the 'carve-out').

It will immediately be noted that agencies that had previously side-stepped the operation of Chapter 7 by the simple expedient of including in their contract with the worker a right on the part of the latter to send in a substitute will henceforth be caught – unless they fall within the carve-out.

However, the carve-out – at least in its present form – is poorly drafted. It is taken from the language of (old) Chapter 7 and looks to whether there is supervision, direction or control as to 'the manner in which' the services are provided. And where such supervision, direction or control exists, the opt-out will not apply. However, the lapidary serenity of the formulation disguises a number of practical difficulties.

First, in a series of examples, the consultation paper assumes that the carve-out will not be satisfied if, for example, the worker is directed as to the order in which he is to perform tasks. However, intermediaries will certainly wish to put before the courts the question as to precisely what the words 'the manner in which' cover. And it may well be that the approach taken in the consultation paper to the question of supervision, direction and control does not find wholehearted judicial support.

Second, the consultation paper seeks to address the 'policing' problems which bedevilled the application of IR35 by placing the burden of proving that the carve-out is met on the intermediary. However, this is likely to have a limited effect on a well advised intermediary in light of the so-called 'best available evidence' rule.

Third, the carve-out, as presently drafted, seems to ask the question whether both: (1) an individual (likely in practice to be the site foreman) habitually issues instructions to the worker; and (2) the worker habitually obeys those instructions. Put in these terms, and given the factual exigencies of agency work on a building site, the carve-out may not be difficult to satisfy, in the case of most (certainly most skilled) workers.

Fourth, the carve-out is extended to a situation where 'the manner of the worker's involvement in the provision of the services' is not subject to supervision, direction or control. Those words appear to relate back to the equivalent in proposed s 44(1)(a). However, it is not easy to see what, in practice, they accomplish; when will the *manner of one's involvement* in providing services be subject to supervision, direction or control?

The wood and the trees

There are a number of difficulties inherent in the language the draftsman has chosen. And if one steps back from the trees and observes the wood, the picture grows still more confused.

First, the legislation will have the effect that it is much easier for a worker to be self-employed for tax purposes if he is engaged directly by the engager (a bipartite relationship) than if he is engaged through an intermediary (a tripartite relationship). If he is engaged directly, all three of the 'irreducible core' requirements of a contract of employment – mutuality of obligation, control and the obligation to perform the services personally – must be satisfied before he will be taxed as an employee. However, if the worker is engaged through an intermediary, the presence of only the second of these requirements will suffice to cause the worker to be taxed as an employee.

It is difficult to see what sensible public policy objective might be said to be served by such a distinction. And even if there were such a public policy objective, it is unlikely that it will be met. Agencies can (relatively easily) adjust their business model so that they face the easier bipartite test than the more complex tripartite one.

Second, the consultation paper proceeds from an assumption that what it describes as 'false self-employment' – particularly in the construction industry but spreading to other sectors – is widespread. This assumption is an important one, providing (as it does) the fiscal spur to action: the impact assessment estimates that in excess of £520m will be raised in the tax year 2014/15 by the measures. However, the notion of false self-employment is undefined and unexplored (certainly by the consultation paper), and evidence of its scale is similarly sketchy. I will cheerfully eat (one of the thinner) volumes of *Simon's Tax Cases* if the measures raise even a quarter of what the Treasury presently asserts will be caught.

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Third, the consultation paper seems to assume that false self-employment is necessarily synonymous with a lower tax burden. Whilst this may be true of many sectors, it is certainly not true of the construction industry (in which, according to the consultation paper, 80% of 'false self-employment' is to be found). Workers in the construction industry typically suffer a deduction of tax of 20% (although sometimes as much as 30%) at source. This deduction will exceed the aggregate of their liability to tax, NIC and their 'employer's' liability unless that worker earns in excess of between £300 and £400 per week.

Finally, although it is perhaps not a matter for the pages of this journal, the consultation paper evinces a number of fundamental misconceptions as to the role that intermediaries play in the employment market – and it is open to question whether the proposed measures truly recognise David Gauke's commitment in the foreword to the consultation paper to continue to support enterprise through the tax system.

Conclusions

That there is false self-employment is not open to serious question, and that intermediaries are often used to facilitate that status, too, is beyond doubt. However, the present measures look set to be yet another in a long list of botched attempts to tackle an issue which the draftsman seems not to have understood, either in nature or in scale.

HMRC's consultation paper, Onshore employment intermediaries: false self-employment, is available via www.bit.ly/1jIBRHX. The consultation closes at 12am, 4 February 2014. Responses can be sent by email to consultation.intermediaries@ hmrc.gsi.gov.uk.