Different Ways of Working

By Abi Adams, Judith Freedman & Jeremias Prassl

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The legal classification of labour is under increasing pressure: different ways of working — from the growth of self-employment to the rise of the on-demand economy — no longer fit into our established structures of employment and tax law, and challenge the fundamental assumptions on which the pension and social security system are built. A series of official reviews have been tasked with resolving the resulting problems, albeit sometimes from narrow perspectives. This workshop will bring together academics and officials from across different disciplines and departments to explore the current rules in employment law and tax law, and to work out how they are failing to meet the needs of employers, workers, and regulators.

This pack contains an overview of the workshop's aims and logistics, as well as three very short notes setting out key background questions and materials. The day will be structured to encourage discussions amongst and contribution from all attendees and understand the many facets of the problem, strictly subject to the Chatham House Rule.

We look forward to welcoming you to Oxford!

Abi Adams
Judith Freedman
Jeremias Prassl

Schedule

10:00	Coffee
10:30	Introduction
10:45	Impulse Papers
11:30	Roundtable Discussion
12:45	Lunch
14:00	Roundtable Discussion
15:30	Concluding Remarks

Following brief introductions of all participants, Professors Abi Adams (Economics), Judith Freedman (Tax Law), and Jeremias Prassl (Employment Law) will offer brief discussion papers on the basis of the attached briefing note. Discussion will then be opened for two Roundtable Sessions, strictly subject to the Chatham House Rule, with contributions from all attendees.

The morning discussion will centre on two fundamental questions.

1) Does the rapid growth of self-employment and the 'new business models' of the on-demand or gig economy present genuinely new challenges, or are these simply manifestations of more fundamental difficulties with the classifications developed since the 19th century?

2) Is it wise to search for a single solution for different regulatory domains (tax, employment, pensions, ...), or do we need to examine the objectives of each form of regulation and find an approach for each area, attuned to specific regulatory goals? What are the advantages and disadvantages of either approach?

The afternoon session will be explore broader questions regarding avoidance and enforcement, and related policy objectives.

Aims

Following the workshop, we will compile a clearer account of the different problems encountered in each domain as a first step towards constructing a practical and coherent framework for the way forward. We hope to organise a major international conference, including policy makers and academics from other jurisdictions in the late spring of 2017 to present and discuss the results of this work.

Contact

The workshop will take place in The Boardroom, Said Business School, University of Oxford, OX1 1HP. The Business School is immediately adjacent to the Oxford Rail Station, and a short walk from Gloucester Green Bus Stop.

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I. The Current Situation: A Brief Overview

1. Self employment is at its highest level in the last forty years, with 1 in 7 workers (∼4.8 million) declaring this as their main form of economic activity. Further, more individuals are mixing employment with self-employment; the number of individuals declaring employment and/or pension income in addition to self-employment income has increased at a faster rate than the numbers in self-employment overall.[1]

2. More individuals are supplying their labour through incorporations. The 2006 Companies Act abolished the legal requirement for companies to have at least two directors. Single-director companies accounted for all growth in the total number of incorporations since 2007. The Labour Force Survey (LFS) suggests that employment among sole directors of their own limited business increased by ∼25% between 2014-15.[2] However, do note that while official statistics typically focus on the growth of single director companies, Personal Service Companies may have more than one director and many existed in this form prior to 2006.

3. These developments are having a negative impact on the public finances. Labour income earned as an employee is taxed more heavily than self-employment income, profits, and dividends. The OBR estimates that the trend towards incorporation will reduce total receipts by £3.5bn in 2021-22.[3] The Treasury estimates that in excess of £2.5bn is lost in revenue on account of the lower NI contributions of the self-employed (that is not attributable to reduced pension & social security eligibility).[4] Further, the loss in tax receipts from small traders below the turnover limit for VAT registration is estimated to cost the government £1.6bn this year.

4. Inadequate pension savings and lower access to social security protection are among the wider concerns voiced about the rise of self-employment. The RSA estimate that the self-employed are half as likely to be contributing to a private pension as employees and, for those who do contribute, their accumulated pension pot is about half the size.[5] While more research is required to determine whether this can be explained by differences in characteristics, the self-employed do not benefit from employer contributions, reducing the incentive to sign up for a scheme, and are not affected by the introduction of auto-enrolment.

5. Employment rights differ across legal categories. The self-employed do not gener-

[1] The number reporting income from self-employment rose from 4.17m in 1999/00 to 5.50m in 2012/13, an increase of 32%. The numbers reporting both self-employment and employment income rose by 49% in the same period. See OTS Report on Employment Status, Table 1.B.

[2] Office for Budget Responsibility, *Economic and fiscal outlook: November 2016*, 121.

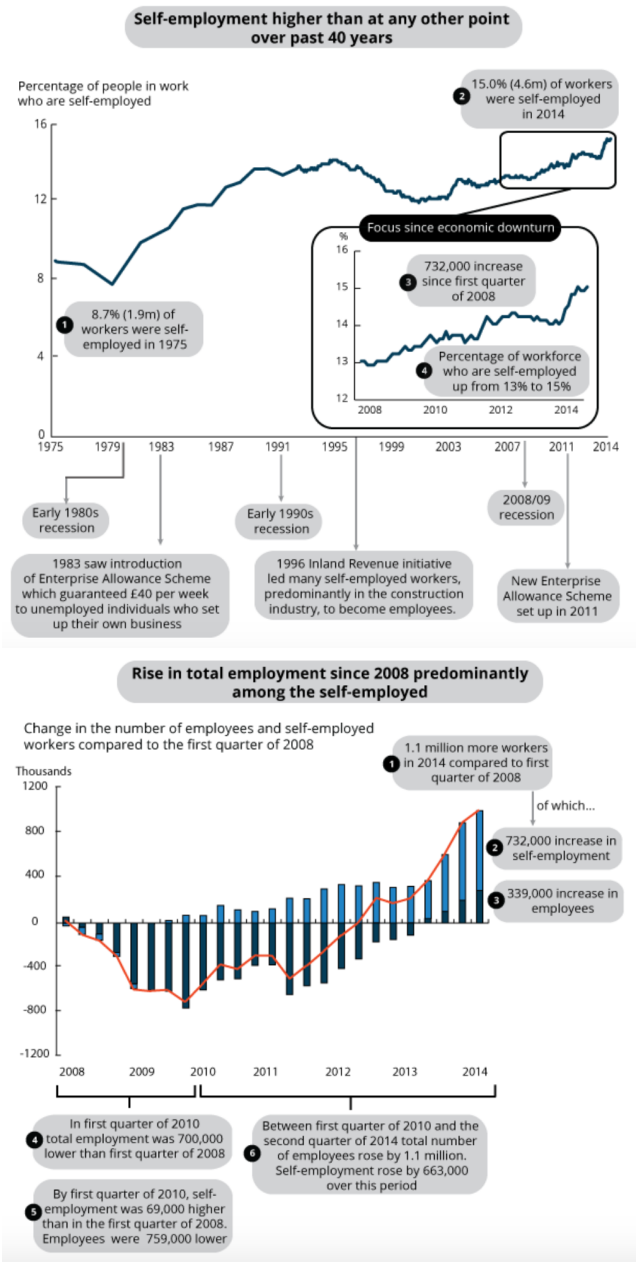
[3] Office for Budget Responsibility, *Economic and fiscal outlook: November 2016*, 123.

[4] HMRC, Estimated costs of the principal tax expenditure and structural reliefs, December 2015.

[5] RSA, *Boosting the living standards of the self-employed*, March 2015

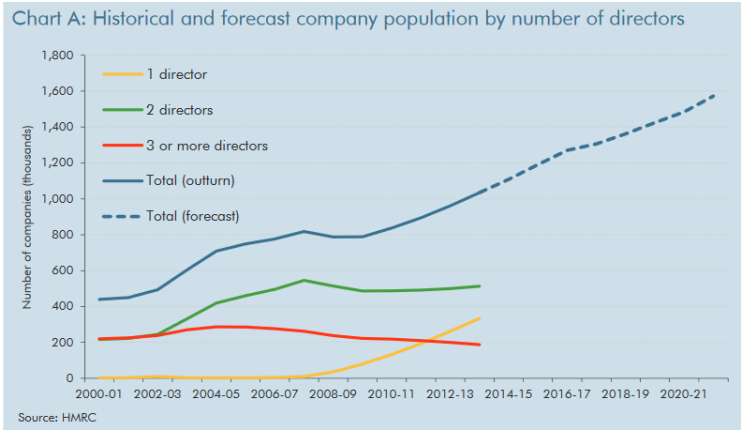
ally fall within the scope of employment law, such as family and sick leave or working time limits. They are also outside the scope of the National Minimum Wage Act, so will not benefit from planned minimum wage increases.

Figure 1. Recent Changes in Self Employment



Source: ONS Calculations on LFS Data, *Self-employed workers in the UK - 2014*

Figure 2. Recent Changes in Incorporations



Source: Office for Budget Responsibility, *Economic and fiscal outlook: November 2016*

II. Incentives

1. Under the current tax and employment systems, similar economic activity can be classified into different legal forms, with financial incentives to adopt one legal form over another.

2. For an engager who wishes to avoid responsibilities and cost, labour law and taxation offer a similar incentive; that is to treat those supplying services to the engager's business as self-employed contractors. The tax system provides a further incentive for both the engager and the person supplying the services for the service provider to incorporate. Not only does this save both parties NICs (and some tax in the case of the service provider) but in practice it also makes it easier to show that the employment relationship does not exist.[6]

3. A person providing services might wish to be, or might be better off being, protected by labour law. However, at the same time, this person could save tax and NICs by being treated as self-employed or as providing services through a company. In some cases, those providing services will be persuaded to operate as self-employed or through companies by the engager (some businesses and even public authorities will only deal with incorporated contractors). In other cases it might be an arrangement that they have initiated themselves. In these cases we can see that the incentive of seeking the protection of labour law is in tension with the tax and National insurance consequences.

4. In practice, the degree to which self-employment or incorporation is favourable to the person engaged will vary. For the medium to higher paid there may be

[6]Despite the existence of anti-avoidance legislation, known colloquially as IR 35.

considerable advantages to self-employment/incorporation. Recent academic studies suggest that the degree of income shifting between self-employment & incorporation is high for the profitable self-employed (Tazhitdinova, 2016) and that the elasticity of corporate taxable income is high for owner-manger firms (Devereux and Liu, 2015). Further, ONS figures suggest that the largest growth in self-employment has been amongst managers, directors, and senior officials.[7] Yet, it is important to note that there are well publicised cases arrangements in which lower paid taxpayers are not the ones reaping the main benefits of the arrangements set up with an aim of taking them out of the employment of the engager.

5. Neutrality is a central principle of an efficient tax/regulation system. A neutral tax system taxes similar activities similarly and in so doing does not create incentives for individuals to distort their behaviour to move from high to low taxed activities. This points to the importance of:

(a) The likely futility of introducing new categories to deal with emerging forms of work. If these categories are close substitutes this raises the likelihood of agents distorting their behaviour to fall into the cost minimising category and will likely increase the complexity of the tax system.

(b) The need to consider the employee — self-employment and self-employment — incorporation boundaries simultaneously. By, for example, reducing the tax advantage of self-employment relative to employment, one may increase the rate of tax-motivated incorporation. There is therefore an argument for combined rates of corporate and shareholder taxation to be at a similar level to labour income taxation for this reason.

(c) Using specific subsidies/targeted policy reforms to promote/discourage particular activities rather than use the tax system for this purpose. Income from similar economic activity should be taxed at similar rates to avoid distortions to behaviour.

The IFS' *Mirrlees Report* suggests some foundations for reform along these principles.[8]

6. By reducing the cost differentials between different legal forms, one reduces the incentive for individuals to move between different categories simply to eliminate tax or employment law obligations. The OTS is conducting a comprehensive review of NICs and income tax, recommending closer alignment of NICs for employees and the self-employed and for employers NICs to be based on payroll costs. It is acknowledged that this will "take the heat out" of the issue of employee status.

[7] ONS, *Self-employed workers in the UK - 2014*
[8] See Crawford & Freedman in *Dimensions of Tax Design*, (2010) OUP.

III. Employment Law

1. For employment law, the rise of self-employment in general, and the 'gig' or 'on-demand' economy in particular, raises at least three sets of questions. Conceptually, many of these have long been recognised — but the quickening pace of labour market changes takes many challenges to their logical extreme.

Employment Status

2. Employment Status is classically characterised as a spectrum, with employees as the core group entitled to the full range of employment rights, independent contractors working under contracts for services beyond the scope of nearly all protective norms, and workers as an intermediate, marginal category entitled to a basic floor of protection.

In reality, however, it is questionable whether the distinction between employees and workers is still relevant: the intermediate worker category has become more and more centrally relevant, as the key rights available to employees alone (including notice periods, unfair dismissal protection, and statutory redundancy pay) are linked to qualification thresholds and therefore of reduced significance to a casualised workforce. The majority of employment rights today (including minimum wage, working time, whistleblowing and discrimination protection), apply'from day one' and extend to all workers a category which is close to that of employee but extends slightly more broadly. The first and key issue is therefore to understand whether this employment status system, poised between the binary and tripartite, is still desirable in theory and in practice.

Contracting Out

3. A second issue arises from some employers' (and, more rarely, employees') attempts to classify work as independent service provision, whether through contractual terms, the use of outsourcing agencies, or a reliance on personal service companies. Whilst the courts have been able to develop doctrines to address some of these strategies, notably as regards the insertion of 'sham' contractual terms, other problems remain.

4. This is particularly true in the case of single-employee incorporation, which even when undertaken on the employer's specific behest has been held to defeat the application of the most basic employment law norms such as anti-discrimination law. Another example is the legal classification of zero-hours work, which in some cases has been characterised as outside the scope of employment law as a result of the intermittent nature of the work.

5. Even where an individual could in principle establish employment status, the rise of multi-employer scenarios can make it difficult to ascribe responsibility accurately. A first example is multilateral employment, including corporate groups or agency work. The presence of multiple entities can make it difficult, for example, to determine responsibility for minimum wage violations or compliance with worker consultation obligations. In other cases, multilateral employment can even be used strategically to deny employment status outright.

6. A related problem arises in simultaneous and /or successive employment, where a worker is engaged by a number of employers for short periods in quick sequence (and may even been self-employed for some stints). The resulting fragmentation of work causes problem for the determination of responsibility (which employer should be responsible for rest breaks?), or even in deciding whether a right has been accrued in the first place.

IV. Tax Law

Employment status and incorporation

1. Taxation rules in the UK work both with and in tension with labour law. The position is further complicated by the fact that liability to pay National Insurance Contributions (NICs) on the basis that there is an employment usually (although not always) follow tax liability.

2. The core statutory language used in connection with taxation is that of employment and not 'worker' (section 4 of the Income Tax (Earnings and Pensions) Act 2003). The term 'worker' is used in relation to special provisions for agency workers (as defined within the legislation). The term 'worker' is also used in relation to arrangements made by intermediaries (under the personal services intermediaries legislation know as 'IR 35') but in that case the provisions apply only where there would be an employment if there was a contract between the clients and the worker. Therefore, for example, the fact that drivers in the recent Uber case were held to be 'workers' does not determine the question of whether they are employed for tax purposes (OTS, The Gig Economy, November 2016).

3. As with labour law, the current problems around the rise of self-employment have long been matters of concern, with cases on employment status occurring especially frequently from the 1960s onwards (Freedman, TLRC 2001). These problems have been exacerbated in recent years by changes in organisational structures and the labour market. The 'gig' economy is only the latest manifestation of such changes and raises similar questions to those faced previously, albeit in a different form.

4. The use of personal service companies in an attempt to take people out of employment has increased. The changes have been encouraged by increases in NICs and reductions in the rate of corporation tax. Benefits and pensions changes have also played their part, whilst company law has been deliberately reformed to increase the ease by which a taxpayer can incorporate a personal services company at a low cost, with limited audit and disclosure requirements, and the need for only one director.

5. Recent changes to dividend taxation might slow the trend to incorporate, but incentives to incorporate remain (Loutzenhiser [2016] BTR 674). As set out in the overview above, the Office for Budget responsibility estimates that incorporation will continue to rise much faster than employment, reflecting the tax advantages of this arrangement. The OBR estimates that this will take (an additional) £3.5 billion off total receipts in 2021-22. This takes into account further planned reductions in corporation tax, reaching 17% by 2020.

6. The case law does not work well to define employment status for tax purposes,

being outdated and unsuitable for its current purpose in many cases. In theory the case law is identical across tax, labour law and other areas of law. However in addition to statutory differences the attitudes of the courts in the different types of case can lead to different results. Since the issue s often a question of fact it is hard to ensure consistency.

7. Special legislation has been introduced to deal with agencies and the construction industry, intermediaries and managed service companies. This greatly increases the complexity of the tax system and thus compliance and administrative costs. The IR 35 legislation is the subject of many complaints and investigations, with a succession of administrative reforms introduced that are intended to improve it, but no real solution found. (OTS Employment Status Report, 2015).

8. A well designed tax system will seek to tax those playing similar economic roles in a similar way to achieve tax neutrality unless there is a good reason to do otherwise (Crawford and Freedman in Dimensions of Tax Design, (The Mirrlees Review), 2010). There is some debate about whether an employee and a self-employed person are playing similar economic roles, because a self-employed person is seen as taking greater risks. Given the number of zero -hours contracts that exist, it is not clear that this is true. Not all self-employed persons or incorporated businesses take risks either- some will have a very well established relationship with one engager. The tax system seems too crude a tool to reflect varying risks in a sensible way. Reduced NICs for the self-employed not attributable to reduced pensions eligibility amounts to around £2.8 billion now and is set to increase as a result of pensions changes. Other benefits entitlements differences do not fully account for this difference.

One answer or many?

9. One approach to the problems outlined would be to align all definitions across employment, tax and NICs law. There are very strong arguments for aligning tax and NICs, as the OTS has pointed out, but the political and practical difficulties are not to be under estimated, although steps are being taken in the right direction. (OTS, Closer Alignment of Income Tax and National Insurance, 2016).

10. There does seem to be a strong argument for aligning employment status for labour law with NICs too, given that many benefits relate to employment rights such a sick pay, maternity pay, job seekers allowance. However the contributory nature of NICs has been severely weakened over the years, both in terms of payments made and benefits payable and full alignment with income tax would break it completely.

11. From a tax point of view a strong argument for employment treatment is to enhance compliance and to simplify administration. The PAYE system is an efficient way of collecting taxation in many cases, although it works less well when there are multiple engagements and short term employments. The making Tax Digital

programme, with its personal tax accounts on line, opens up possibilities for administrative reform that may not need to depend upon employment status at all. So, for example, platforms like Amazon and Uber could have tax collection functions regardless of the employment status of those providing services. Should this be considered separately from employment law or would that undermine employment law in some way?

12. Could the provision of new legal forms or arrangements be used to reduce tax driven incorporations? The OTS has proposed the creation of a status of Sole Enterprise with Protected Assets (SEPA) to protect the main residence of the business owner, without incorporation (OTS, July 2016). They have also investigated a look through regime for small companies, but have rejected this option recently (OTS, November 2016). Whether or not SEPA would have value in its own right, it seems unlikely to prevent tax driven incorporation if tax advantages remain. Are there other structural reforms of this type that might be helpful? And how would any kind of new legal form to inhibit incorporation interact with employment law issues?