Low Incomes
Tax Reform
Group
A voice for the unrepresented

Independent Review of Employment Practices in the Modern Economy
Response from the Low Incomes Tax Reform Group (LITRG)

1 Executive Summary

1.1 As tax specialists with an interest in the tax and related welfare issues of the low-paid, and as part of the Chartered Institute of Taxation (CIOT) with a remit to put forward the perspective of unrepresented taxpayers on low incomes, LITRG welcomes this.

1.2 A major concern of LITRG is the impact that 'non-standard work' such as agency work, zero-hours contracts and certain coercive forms of self-employment have on the low-paid, particularly with regard to their tax, National Insurance (NIC), tax credit and benefit positions.

1.3 While we appreciate that such matters are not expressly within the review's terms of reference, we note that 'security, pay and rights' are. In our view one cannot understand what impact modern employment practices have on a worker's security, pay and rights, without considering tax, National Insurance, tax credits or other welfare issues.

1.4 We say this for reasons which include the following:

- Exploitation of workers often manifests itself in problems with their tax and NIC such as employers not paying over withheld amounts of Pay As You Earn (PAYE) to HMRC. Even where there is no legal wrongdoing as such, minimising or avoiding tax or HM Revenue & Customs (HMRC) administration is often a factor in terms of employers offering non-standard forms of work over full-time, permanent, direct employment.

- Not only can this type of work make workers' lives insecure and unfulfilling but there is a huge knock on effect on public finances – both direct and indirect. Much of the welfare system is funded from general taxation. It follows that we may see erosion

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of the social safety net in the longer term due to potential funding issues – something to keep in mind when considering a worker's 'security'.

- Regardless what action is taken around employment law status as a consequence of this review, the fact remains that the distinction between employment and self-employment for tax purposes is an ongoing source of confusion and trouble for workers. Many of them are likely to have extremely limited or indeed no real understanding of the current framework even though an incorrect status can potentially lead to problems for them later down the line.

- Statutory payments such as sick pay or maternity pay, often thought of as employment law 'rights', are actually dependent on whether there is a 'secondary contributor' (i.e. someone that pays Employers' National Insurance). In cases where a worker is paid and taxed as self-employed (whether or not they are a 'worker' for employment law purposes) there will not be a secondary contributor. The situation is therefore far more complex than is often presented and demonstrates the overlap that exists between employment law and tax law when thinking about 'rights'.

- A person's tax credits or Universal Credit (UC) status may follow their tax status; so if a person is treated as self-employed for tax purposes, then this means they may be treated as self-employed for tax credits or UC purposes, but because there are some distinctions in the respective rules this rule of thumb cannot always be relied upon. Both DWP for UC and HMRC for tax credits say they are not bound by any decision made by HMRC in respect of tax. The rules for the self-employed tend to be less generous/more burdensome than for employees.

1.5 Taking all of these things into account, we think that a comprehensive review of tax and related issues around non-standard work should be carried out as a matter of urgency. We therefore hope that a recommendation to this effect is made by Matthew Taylor. We also suggest that the above areas feature as key themes.

1.6 In terms of issues that fit more squarely within the remit of this review we know from 'workers' who write to us that they are often not aware of their employment status and therefore what employment rights they are entitled to. Even if they can be sure of their rights, they often have no practical way of securing them.

1.7 In answer to the specific question of 'Do current definitions of employment status need to be updated to reflect new forms of working created by emerging business models, such as on-demand platforms?' we would repeat a recommendation that we have previously made in the Department for Business, Energy and Industrial Strategy (BEIS) review into *The future world of work and the rights of workers* last year and taken up by the Work and Pensions Committee in their report on *Self-employment and the gig economy* that individuals should be treated as 'workers' (at least) unless the engager of their labour can prove otherwise. By essentially reversing the burden of proof regarding 'worker' status, some of the barriers to workers understanding and enforcing their rights will hopefully start to melt away.

1.8 We are happy to discuss any aspect of our response in more detail or to meet if easier.

2 About Us

2.1 The LITRG is an initiative of the CIOT to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.

2.2 LITRG works extensively with HMRC and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Our approach

3.1 Stemming from our interest in the tax and related welfare position of individuals on low incomes, much of our published work concentrates on issues that we consider are relevant to our call for a comprehensive review of non-standard work from a tax perspective.

3.2 The purpose of our submission is therefore to summarise the most pertinent points of some of our recent pieces of – work blogs, consultation responses, inquiry submissions and the like – and as they are already published on the internet, link to them in case the review team wish to refer to them further.

3.3 We do this under six broad headings:

Section 4 – How the tax system drives non-standard work

Section 5 – Impact on the tax base

Section 6 – The complexity of status for tax law

Section 7 – Statutory payments

Section 8 – Tax Credits and Universal Credit

Section 9 – 'Worker' status and rights

3.4 In section 9 we look at 'worker' status and rights from our perspective as tax rather than employment law specialists. Our recommendation is founded in our belief that the problems workers face in terms of understanding their employment status and enforcing their rights are rooted in the same ground as the tax issues that we come across – the workers' own lack of knowledge of their rights, and the engagers of their labour having little fear of any enforcement action being taken against them.

3.5 Taken together, we hope that the review team will find our submission, as well as the detail in our existing pieces of work, helpful and insightful.

4 How the tax system drives non-standard work

4.1 In our response to the Department for Business, Innovation and Skills (BIS) consultation *Tackling Exploitation in the Labour Market*[1] we set out how exploitation of workers can often manifest itself in problems with their tax and NIC – for example employers deducting tax and National Insurance from their workers but failing to pay it over to HMRC. This often results in the workers having to pay twice.

4.2 While perhaps not in the same league as this, being caught up in non-standard forms of work such as zero hours contract work or agency work can also make a worker's life difficult. Yet the tax system effectively encourages some engagers to offer this type of work in preference to full-time, permanent, direct employment.

4.3 For example, there are incentives for employers to keep a worker's hours low by virtue of a zero/short hours contract (or indeed to split up previously full-time jobs into separate part-time jobs) due to the fact that employers' National Insurance (payable at 13.8%) is only payable when wages rise above £157 week. This equates to 20 hours at the National Living Wage (NLW).

4.4 There are also other tax related employer obligations that can be avoided or minimised by keeping a worker's pay low. For example, if I am an employer and I only offer 15 hours a week at the NLW (equating to earnings of less than £113), I can potentially avoid:

- having to pay Statutory Sick Pay – currently payable at around £89 a week (for a maximum of 28 weeks) which, since April 2014, is not reclaimable from the Government for any employers;
- having to pay parental payments, e.g. Statutory Maternity Pay – much if not all of which is reclaimable from the Government, but payments can be hugely complicated to understand and administer (particularly the Statutory Parental Pay

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1 http://www.litrg.org.uk/sites/default/files/151123%20Tackling%20exploitation%20in%20Labour%20Market%20-%20LITRG%20response.pdf

rules which were introduced from April 2015 – the technical guidance is 66 pages long and there are possible penalties of up to £3,000 if I get things wrong);

- having to pay any contributions into my workers' pension scheme which I have had to set up for them under the auto enrolment programme (in rollout since 2012). Currently I have to pay 1% of qualifying earnings, but this is set to rise to 2% and then 3%, in April 2018 and April 2019 respectively;

- having to register as an employer with HMRC or operate a payroll at all, if I manage to keep *all* my workers' pay at under £113 per week. This lifts a huge burden from my shoulders as I do not have to worry about HMRC's Real Time Information (RTI) system which, since 2013, has required me to submit pay and tax information about my employee to HMRC *every time I pay them* (rather than once, at the end of the year, as used to be the case).

4.5 As another example, these days it seems that businesses are bringing in agency workers more frequently and in some instances are using them instead of directly hired staff to make up the bulk of the workforce, for example as in the case of Sports Direct.[1] One of the reasons for this is that agency workers (if they work under a special type of contract called an overarching contract or 'umbrella' contract) have been able to receive tax- and NIC-free home-to-work expense reimbursements under the 'temporary workplace' rules (swapping taxable salary for tax- and NIC-free expenses reimbursements also saves the employer 13.8% National Insurance on the expense element). Having this 'tax efficiency' throughout the supply chain means that contracts can be negotiated at lower prices, making agency workers a very attractive option for end clients.

4.6 You can read more about our views on how tax policy can help tackle insecure work in our guest contribution to the TUC's ToUChstone blog[2] – *How the tax system is driving people into insecure work in unexpected ways.*

5 Impact on the tax base

5.1 Engagers may be offering 'non-standard work' to avoid or minimise their individual obligations, but collectively, such behaviour will also be leading to a significant fall in government revenues.[3]

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[1] https://www.parliament.uk/business/committees/committees-a-z/commons-select/business-innovation-and-skills/inquiries/parliament-2015/working-practices-at-sports-direct-inquiry-16-17/

[2] http://touchstoneblog.org.uk/2017/05/tax-system-driving-people-insecure-work-unexpected-ways/

[3] The TUC have recently quantified this as being in the region of £4bn - https://www.tuc.org.uk/industrial-issues/workplace-issues/rise-insecure-work-costing-exchequer-%C2%A34bn-year-warns-tuc

5.2 In our view, there is more to this than earnings under precarious zero hours contracts often being under the tax threshold or the fact that engagers of self-employed workers do not pay any Employers' National Insurance. There are less obvious consequences to the tax base of the move towards 'non-standard work'. For example, it seems to us that a great number of those turning to self-employment to make ends meet, particularly those in the gig economy, are young, unskilled, have lower levels of education or are migrant workers with limited English. Many will not usually have had to fill in a tax return before and are unlikely to have spare money to engage an accountant or tax adviser. As a consequence, these individuals have to navigate the complexities of the confusing self-assessment system on their own, which may well result in non-compliance or under-reporting.

5.3 In our submission to the House of Commons Treasury Committee[1] on *The threat to the UK tax base from changing patterns of working*, we set out some further thoughts. We also highlight that non-standard work can lead to potentially more reliance on in-work benefits and that very low or irregular earnings patterns year-on-year could be affecting people's ability to build a National Insurance record for state pension purposes.

5.4 This means that as well as a precarious working life many workers are likely to be unwittingly heading towards an uncertain retirement – and one reliant on means tested benefits. This is further compounded by the same workers falling beneath the threshold for automatic enrolment into workplace pensions, so missing out on employer contributions and failing to amass any private pension.

6 The complexity of status for tax law

6.1 Just as employment law status (i.e. whether someone is an employee, a 'worker' or self-employed) is confusing, so is someone's tax law status (employed or self-employed).

6.2 The law on employment and self-employment is so daunting and vague – what exactly does mutuality of obligation involve and where does the 'irreducible minimum' lie; what degree of control turns a contract from one of self-employment to one of employment; how much weight is to be placed on other factors (e.g. the presence or absence of a right to send a substitute); and so forth. See, for example, *Stringfellow Restaurants Ltd v Quashie [2012] EWCA Civ 1735 (21 December 2012)* where a dismissed lapdancer was told by the employment judge that she was self-employed, by the Employment Appeal Tribunal that she was employed, then by the Court of Appeal that she was self-employed!

6.3 Low-income workers are at a particular disadvantage in terms of status confusion. The well-paid 'consultant' working at a skilled level is likely to be professionally advised such that they structure their business and contracts in a tax-efficient way, and keep records that support their status. By contrast, those on low incomes face a difficult prospect in trying to decide

[1] http://www.litrg.org.uk/latest-news/submissions/170224-further-call-evidence-uk-tax-policy-inquiry

their tax status (that is if they even realise that it is not just a question of choice). This is exacerbated as HMRC's employment status tool has recently been revamped in light of the new IR35 in the public sector rules and is now directed at experts or big business and barely intelligible to individuals on low incomes without access to advice.[1]

6.4 In our response to the Office of Tax Simplification (OTS) – *Employment Status Review,*[2] we describe how people in certain professions may have acute difficulty in getting to the bottom of their tax status. For example, there has been a substantial rise in the numbers of people employed in care and support/personal assistant roles and it is expected that this trend will only increase.[3] Difficulties arise in determining status because naturally the lives of a carer and the person for whom they care tend to be more closely intertwined than in other industries where the boundaries between employer/employee and engager/contractor are more clearly demarcated. For example, personal assistants/carers may struggle to fall within some of the traditional 'tests' of self-employment status, such as *right of substitution* – by virtue of the very personal nature of their relationship with their client, it may not be appropriate for an assistant to be able to send someone else in their stead.

6.5 Under the PAYE regulations, the general principle is that it is the engager's responsibility to get tax status right. However, where an employer can satisfy HMRC that they took 'reasonable care' and any error was made in good faith or where the employer's failure appears to be willful, and the employee was aware of the situation HMRC can direct that the tax (and interest) is recovered from the employee.[4] As such, it is vital that a worker is able to understand their tax status for themselves.

6.6 To provide clarity and certainty to workers, we think this whole area needs to be simplified and made more transparent. At the very least government guidance on tax status issues should be improved – remembering that workers may be young, may have lower levels of experience, education or literacy or may have English as a second language.

7 Statutory payments

7.1 Sick pay and parental pay are a very important part of the safety net for workers. Indeed this review specifically alludes to this in the terms of reference when it says: 'To what extent does the growth in non-standard forms of employment undermine the reach of policies like

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[1] https://www.gov.uk/guidance/check-employment-status-for-tax

[2] http://www.litrg.org.uk/sites/default/files/150105_LITRG%20response%20OTS%20employment%20status%20FINAL.pdf

[3] This is something LITRG has itself attempted to rectify for care and support employers by means of our Disability Tax Guide project (http://www.disabilitytaxguide.org.uk/)

[4] http://www.legislation.gov.uk/uksi/2003/2682/regulation/72/made

the National Living Wage, maternity and paternity rights, pensions auto-enrolment, sick pay, and holiday pay?'

7.2 However there is much confusion and misinformation as to when 'workers' might be entitled to sick pay and parental pay – this is unsurprising given the standard of information on GOV.UK (indeed the page on 'worker' rights[1] avoids the question completely by saying that 'workers' *may be* entitled to statutory payments which is less than helpful[2]).

7.3 Further, some media commentary[3] on the recent announcement that Uber are now offering drivers access to sickness and injury cover[4] seems to suggest that if Uber drivers are classified as 'workers' under employment law (Uber are due to challenge the judgement that their drives are 'workers' later this year) then they will become entitled to Statutory Sick Pay. However this is incorrect. In fact the situation is as follows: not all workers in non-standard forms of employment will be entitled to sick pay. Those paid through PAYE (for example, this would usually include agency workers and zero hours contracts workers) will be entitled provided they meet the earnings criteria,[5] however those in dependent self-employment, such as those working in the gig economy, will not be – regardless of their level of earnings. This is because these people are usually treated as self-employed for tax purposes and so are paid gross.

7.4 Not being paid via PAYE means that there is no secondary contributor (someone who is liable to pay Class 1 secondary – i.e. 'employer' – NIC). Secondary contributors are responsible for administering and part-financing statutory payments under the Social Security Contributions and Benefits Act 1992. If there is no secondary contributor, then it follows that the worker cannot be entitled to Statutory Sick Pay or any other statutory payments such as Statutory Maternity Pay.

7.5 Gaining entitlement to Statutory Sick Pay (and other statutory payments) may therefore require a change in the worker's tax status rather than employment law status – another compelling reason for there to be a review of tax and non-standard work.

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[1] https://www.gov.uk/employment-status/worker

[2] Neither is the seeming contradiction that agency workers may be entitled to Statutory Maternity Pay but not Statutory Maternity Leave – this requires unpacking immediately: https://www.gov.uk/agency-workers-your-rights/maternity-rights-for-agency-workers

[3] https://www.theguardian.com/technology/2017/apr/27/uber-to-offer-uk-drivers-sickness-cover-in-return-for-2-a-week-fee

[4] https://newsroom.uber.com/uk/ipse/

[5] Average weekly earnings need to be £113 (in 2017/18).

8 Tax credits and Universal Credit

8.1 Tax credits and their replacement UC offer a lifeline to low-paid workers in non-standard forms of work. However the rules create a disparity between the employed and self-employed. While an employed claimant will generally receive working tax credit if they are in 'remunerative work' and normally work for the requisite number of hours per week, a self-employed claimant faces a test of whether their self-employed activity is carried on upon a commercial basis with a view to a profit and is organised and regular, which can involve onerous compliance checks. In addition, a self-employed UC claimant's benefit is restricted if they do not earn each month a minimum amount which equates to the NLW for (usually) 35 hours a week (the 'minimum income floor' or MIF), a burden which is not imposed upon employed claimants.

8.2 In our submission to the Work and Pensions Committee inquiry, *Self-employment and the gig economy,*[1] we describe how significant compliance burdens tend to be placed on the self-employed across tax credits and UC in comparison to employees. We also demonstrate how in UC the MIF[2] rules penalise those who have fluctuating incomes and those who have big business expenses that fall in one month rather than spread over the year – leaving the self-employed claimant worse off than their employed counterpart in similar circumstances.[3] Another disparity between the employed and self-employed is created by the fact that the MIF does not take any account of pension contributions, which are usually 100% deductible when calculating net income for UC purposes.

8.3 While the legal definitions of self-employment in tax credits and UC are based on the concept of a 'trade, profession or vocation' from tax law, there are also additional requirements in both benefits for the person to be recognised as self-employed. However, both DWP and HMRC (for tax credits) stress that they are not bound by a HMRC decision for tax purposes in determining whether the person is carrying on a trade, profession or vocation. This, coupled with the additional requirements to establish if someone is self-employed, can add to the person's confusion about their status – for example they could be told they are a worker for employment law, self-employed for tax but they could be refused working tax credit because they are not 'self-employed' for tax credit purposes. When thinking holistically about a person's security, rights and pay then, this is another reason why tax status cannot be overlooked.

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[1] http://www.litrg.org.uk/sites/default/files/files/170116-LITRG-response-WPC-self-employment-FINAL.pdf

[2] http://revenuebenefits.org.uk/universal-credit/guidance/entitlement-to-uc/self-employment/minimum-income-floor/

[3] The Work and Pensions Committee has subsequently called for an urgent review of the UC MIF.

9 'Worker' status and rights

9.1 Finally, we would like to make some comments around 'worker' status.

9.2 The current employment framework means a person's entitlement to employment rights is determined by their employment status. Yet often, the correspondence that we receive from workers regarding their tax positions exposes issues that they are facing with their employment law status. For example, there seem to be increasing numbers of agency workers paying to use umbrella companies in an effort to secure 'employee' rights (rather than any tax advantages outlined in section 4) – swayed by marketing material such as the following:

> *'If you join an umbrella company.... you'll receive the best of both worlds. Not only will you be able to benefit from all the perks contracting offers, you'll also have access to the same rights and benefits given to permanent employees. These include holiday, sick, and maternity & paternity pay.'*[1]

9.3 We think the implication here is that you have no basic rights as an agency worker – which of course is incorrect.[2] We think this could be scaring workers into paying for the 'employment services' of an umbrella company unnecessarily. A recent Citizens Advice press release[3] saying that half of people on zero hours contracts, and two in five people on temporary contracts, wrongly believe they are not entitled to paid holidays further illustrates the issue of workers not understanding their status or rights.

9.4 The starting point is that most workers in non-standard forms of working such as zero hours, agency workers and dependent self-employed (such as gig economy workers) are all likely to have 'worker' status and therefore have rights to the basic protections such as holiday pay and the minimum wage.

9.5 Even though their employment law position is actually quite straightforward, we think that they would have difficulty arriving at that conclusion from the GOV.UK 'worker' guidance[4] – which as we have alluded to previously in this submission – is very confusing. It is also incomplete – the fact that 'workers' are entitled to auto-enrolment is missing from the list of rights, for example.

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[1] http://www.parasolgroup.co.uk/help-me-decide/faqs/why-join-an-umbrella-company/

[2] Further, nowhere is it explained to workers that the 'additional' rights that the umbrella company may be able to offer you as an employee as compared to a 'worker' may not be all that valuable considering agency work is not always durable (unfair dismissal or a redundancy payment are only available after two years' service for example).

[3] https://www.citizensadvice.org.uk/about-us/how-citizens-advice-works/media/press-releases/sharp-practices-paid-holiday1/

[4] https://www.gov.uk/employment-status/worker

9.6 In our response to the BEIS review into *The future world of work and the rights of workers* last year[1] we gave some further examples of the inadequacy of GOV.UK and stressed that urgent clarification of the existing 'worker' rules is needed. In addition, we suggested that an interactive tool be developed to assist those seeking to determine 'worker' status and that an illustration of a dependent self-employed 'worker' should be given on the GOV.UK 'worker' page to help them self-identify. Further we stressed that while empowering 'workers' by giving them better information about their status and rights could help address the problem, this also needs to be backed up by an accessible means for them to enforce their position if things go wrong – something that is currently lacking.

9.7 Having said that (and in answer to the question currently before us of 'Do current definitions of employment status need to be updated to reflect new forms of working created by emerging business models, such as on-demand platforms?') it strikes us that another way of dealing with this whole issue would be to say that everyone is at least a 'worker' unless genuinely self-employed. Although genuine self-employment would then need to be identified, we think most people would intuitively have an idea of what this looks like so would have a better starting point to understanding the 'worker' principle.

9.8 This is something that we also recommended in our response to the BEIS review the rights of workers last year[2] (this inquiry is yet to report). We note that the Work and Pensions Committee in their gig economy report suggested something similar as did the Royal Society for the Encouragement of Arts, Manufactures and Commerce (RSA) in their report *Good Gigs – A fairer future for the UK's gig economy.*[3] Given this point of unity as to a 'default workers status' we hope that this is something that will also come out of this review and be taken forward as a consequence.

LITRG
17 May 2017

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[1] http://www.litrg.org.uk/latest-news/submissions/161216-future-world-work-and-rights-workers

[2] http://www.litrg.org.uk/latest-news/submissions/161216-future-world-work-and-rights-workers

[3] https://medium.com/rsa-reports/good-gigs-a-fairer-future-for-the-uks-gig-economy-f2485a22de09