Employed or Self-Employed: where are we now?

September 17, 2010, 6:43 pm

The rules around what constitutes employment and self employment were codified over 40 years ago but it still remains a contentious area. This can be attributed to the differing practical situations that arise, the ambiguity of contractual terms and perhaps most importantly the inconsistency between contractual terms and the practical reality of working arrangements. This is perhaps the contribution the recent Weightwatchers $(WW)_1$ case has made to the established precedent, namely it demonstrated that courts and tribunals will increasingly take the reality of a situation into account and not just focus on the terms of any written contract between the parties.

The WW case held in the First Tier Tax Tribunal and concerned the tax status of leaders working for the weightwatchers organisation. The terms under which the leaders worked were, arguably, contradictory. WW's Self Employment and Income tax booklet, for example, reportedly set out the position that Leaders are self-employed but then stated that this does not affect the leaders' entitlement to receive holiday pay as this was something that all workers were entitled to. Such inconsistencies can prove fatal to an attempt to persuade a court that it should be influenced by an intention of one party to another based on contractual terms, particularly if it is in conflict with what happens in practice. From my experience "self employed" contracts often start their life as employment contracts and herein lies the problem.

Cases involving tax status are invariably made more complicated by the body of relevant legislation such as the Income Tax (Pay as you Earn Regulations) 2003 and The Social Security Contributions (Transfer of Functions) Act 1999, as well as the Working Time Directive. Each of this afore-mentioned legislation has its own terminology and this is often unhelpful in trying to interpret the rules that apply to cases brought before the courts. The tribunal in WW itself observed that it is was unfortunate that H M Revenue& Customs (HMRC) had chosen to use the term "worker" in its determinations, presumably because it is actually a status given by European law to not only employees but also self employed. HM Revenue & Customs often commence their investigation using the Pay as You Earn (PAYE) legislation and then attempt to increase their "tax take" by broadening the scope of their action

This generally leads to a consideration of what constitutes employment and in this context courts still refer to the tests laid down by MacKenna in Minister of Pensions and National Insurance$_2$. This is a 1968 case but is still considered authoritative in setting out the tests of employment and was referred to by the judge in the WW hearing. These tests have been interpreted over time to aid in the definition of self employment. A body of cases has given us the so called "badges" of trade but self employment is still effectively defined in the negative. If someone is not employed then the inference is that he is self-employed. It is because of these facts that the Ready Mixed Concrete case is so important but sometimes this excludes a full consideration of the badges of trade",

which is unfortunate. These indicators of self-employment should, perhaps, be given more importance as they include financial risk which I regard as key in looking at the commercial reality of arrangements between two parties, where the tax status of the person undertaking the work is in doubt.

My favourite illustration of this which I often use during my talks on this topic is taken from the construction industry. If a labour only "self employed" builder constructed a building which subsequently developed a fault due to faulty materials which party would stand the cost of the time to rectify the problem? I would argue that if the builder did this would be a strong indication that he was self employed under a contract for service since he has demonstrated financial risk. If on the other hand the main contractor he was engaged by stood the cost this may indicate a lack of financial risk on the builder's part and lead a court to decide that he is engaged under a contract of service. This is equivalent to' employment and should be distinguished from a contract for service which is analogous to self-employment. I am assuming for the purposes of this example that the contractual terms between the parties regarding tax status are unclear, which is often the case in practice.

The judgement in WW case was very much concerned with the commercial reality of the situation and in my view financial risk is the clearest indication of this in practice. It appears that the Weightwatchers leaders had no financial risk and would find it difficult to align themselves with another one of the badges of trade. Instead the tribunal appeared to take the view that they were entrapped by the criteria set out in the Ready Mixed Concrete case for employment to exist, namely control combined with the inability to provide their own substitute. The contractual terms were of no assistance to them either as they did not appear to accurately reflect the reality of the situation in terms of the employment status of the WW leaders. As early as the 1978 case of Massey v Crown Life Insurance Lord Denning MR stated that "if the true relationship of the parties is that of master and servant under a contract of service, the parties cannot alter the truth of that relationship by putting a different label on it".

Any HMRC team that undertakes an employer compliance visit today will apply the same principles. Businesses should be warned that "false" self employment will always be a target of HMRC and has proved to be a popular line of investigation for them in a number of business sectors. These include one man company contractor situations where the Revenue can use its powers under the IR35 Intermediaries legislation and the Construction Industry where it has always sought to reclassify labour only subcontractors as employed. The former has proved less lucrative than the latter.

Whilst the WW case does not fit either of these typical scenarios it certainly highlights the approach of the revenue in looking for easy targets where the commercial reality does not accord

with the terms of engagement. The rules are plainly set out in the HMRC literature and are also demonstrated by the Employment Status Indicator (ESI) test on their website so businesses who fall foul the rules must share part of the responsibility. Whilst the ESI test is often not conclusive it does at least provide the employment triggers to consider in a given situation and caution should be exercised where the result of an ESI test is unclear, particularly in the case of businesses engaging contractors for long term assignments.

The Professional Contractors Group has long fought for the abolition of IR35 which may be imminent on the basis it is a piece of legislation which few understand. I'm sure, however, that the promised "overall review of small business taxation" will seek to stamp out false self employment in all situations. If this results in clearly written legislation which reflects commercial reality then I think this can only be a good thing. A level playing field is long overdue and should be welcomed by businesses, regardless of whether they engage employees or contractors.

Robert Bradley heads up Bradley & Associates, a Worcestershire based accountancy practice which works closely with legal professionals and is accredited by the Professional Contractors Group.

References:

[1] Weight Watchers (UK) Ltd & Ors v Revenue & Customs [2010] UKFTT 54 (TC) (02 February 2010)

[2] Ready Mixed Concrete (South East) Ltd v Minister of Pensions and National Insurance [1968] 2 QB 497

[3] Massey v Crown Life Insurance [1978] ICR 590, CA (1977 Nov. 2, 3, 4, Lord Denning M.R.