



ICAEW REPRESENTATION 30/17

TAX REPRESENTATION

REVIEW OF EMPLOYMENT PRACTICES IN THE MODERN ECONOMY (TAYLOR REVIEW)

ICAEW welcomes the opportunity to comment on the [Taylor review of modern employment practices](#) publicised by Department for Business, Energy and Industrial Strategy on 30 November 2016.

This response of 6 March 2017 follows a meeting with Matthew Taylor on 21 December 2016 and has been prepared on behalf of ICAEW by the Tax Faculty.

Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

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ICAEW RECOMMENDATIONS FOR THE REVIEW

INTRODUCTION

1. Flexible employment policies, and the ability to hire the right talent in the UK are important to achieve the government's objective to ensure the 'the economy works for all not just the privileged few', and as the UK prepares to leave the EU, maintaining these conditions will be essential to economic prosperity.
2. Evolving business models and employment practices have the potential to change significantly the structure of the UK economy, with potentially major implications for workers and government finances. We believe the review should consider carefully any additional regulatory costs for business, or constraints on business models that might result. This is particularly important for SMEs where the cost of regulation might be proportionately higher.

GENERAL COMMENTS

Tax – especially NIC – is the most urgent issue

3. We believe that an important issue for both individuals and the exchequer is the growth of self employment. Tax is a significant driver in this trend so tax should be a major feature in the scope of this review. We include national insurance contributions (NIC) as a tax for this purpose.
4. Many of the complexities in current practices can be attributed to having different rules for different purposes and any review should seek options for bringing these closer together. There is little correlation between tax and employment law rules, which leads to confusion and opens up the road to error, arbitrage and avoidance.
5. Self-employment levels in the UK continue to rise. For many, this is a popular alternative to employment, giving more flexibility and reduced obligations for both workers and engaging businesses, but the reduced tax, and particularly NIC, costs are a major contributing factor. New terms such as the 'sharing' and 'gig' economies have been coined to describe new business models and ways of working, but, while these indicate changes in behaviour, tax and employment law are unchanged. We do not consider that it is possible to review these new patterns of working without full consideration being given to the tax consequences that, in part at least, have driven their evolution.
6. The review should also consider the extent to which working practices are influenced by the other tax-related costs associated with employment.
7. The gross monetary cost to business of hiring labour as employees will include:
 - National minimum or living wage
 - Holiday pay
 - Sick pay
 - The administrative cost of running a payroll
 - Employment protection costs, such as the costs of unfair dismissal claims and statutory and enhanced redundancy compensation
 - Employers' NIC, currently adding 13.8% to much of the wage bill (and costing employers collectively some £73bn in 2017-18, based on Government Actuary estimates)
 - Pension contributions (affecting all employers by 2018)
 - The apprenticeship levy.

Under non-tax law, only some of the above apply to labour defined by employment law as 'workers'.

8. Under tax and NIC law, certain types of worker are deemed to be in employment (eg, apprentices, the holders of an 'office', and agency workers who are subject to supervision), some are deemed to be self-employed (eg, examiners for NIC purposes only, and deep sea divers for tax purposes only) and some are disregarded (eg, employment by a spouse in a domestic context). There is little or no correlation between the tax and NIC deeming rules and employment law.
9. Labour intensive industries predominate in today's services economy. In these industries, employer NIC is a material additional cost and there is considerable pressure to reduce it using self-employed or intermediary-provided labour if possible.
10. Distinguishing between a contract for work which can be classified as self-employment rather than employment is not always straightforward. Some businesses, which are also concerned with reducing their exposure to tax risk, have opted to engage their staff through intermediaries, such as personal service companies (PSC), umbrella employment companies, or agencies. HMRC has attempted, so far unsuccessfully, to develop an online tool that helps taxpayers decide whether they are looking at an employed or self-employed relationship, and this will shortly be extended to 'IR35'-type relationships.

DETAILED COMMENTS

Tax law and employment law

11. Tax definitions of employees and the self-employed are frequently not the same as employment law definitions, although there is considerable overlap and the core definition of an employee and contract of employment is the same (as it is based on the common law rather than statute). Confusion is frequently caused by the fact that there are three fundamental categories in employment law – employee, 'worker', and self-employed person, whereas tax law treats many 'workers' in the same way as the self-employed, and the remainder as employed earners. References to self-employment in a tax context are therefore often, but not consistently, intended to include people with 'worker' status.
12. We refer to 'self-employed and workers' in the remainder of this paper to mean, collectively, those who are self-employed under both codes together with those who work other than under a contract of employment but commit to personal service and are therefore entitled to 'worker' rights under various employment and pension law provisions. The latter group will mainly be self-employed in tax/NIC law terms.
 - For those in employment (or deemed employment), the employer accounts to HMRC through the PAYE system on behalf of the employee for income tax and Class 1 employee NICs, and also pays employer Class 1 NICs on cash earnings each pay period, plus Class 1A NIC on the taxable value of benefits in kind each year.
 - The self-employed and 'workers' pay their income tax and Classes 2 and 4 NICs through the self-assessment system.
13. Sometimes self employed individuals refer to themselves as businesses, but that is just terminology and the tax position will be the same. A self employed person can also choose to incorporate their business, so adding a further dimension to the tax considerations, but this does not change the nature of the engagement as being either employment or self employment and the personal service companies legislation, popularly described as IR35, and the changes to dividend tax rates seek to equalise the tax payable.
14. It is also important to appreciate that there are non-tax reasons for incorporating. The important reasons for the worker include
 - a. limited liability and asset protection

- b. ability to issue shares to family members and employees
 - c. eligibility for certain government incentives that apply only to corporate entities
 - d. ability to defer income into a later tax year
 - e. ability to make employer pension contributions without paying earnings to the director.
15. A further very good reason is that many large businesses refuse to hire self-employed contractors because of the employment on-costs, current and potential, and insist that the contractors be employed by someone else so as to ensure that there is no risk of unexpected costs falling on the large business. The usual answer to this problem is for the contractor to operate through a PSC, an agency or an umbrella company. Recent and prospective changes to tax law extend the tax definition of employment or create deemed employment income by taking into account matters such as whether there is actual personal service, or a right of supervision, direction and control over the manner in which the worker undertakes the work, or whether the contractor would have been an employee in the absence of the corporate wrapper.
16. Recent employment law case decisions have sought to define 'worker' and the rights to which workers are entitled. A 'worker' has certain employment rights, but fewer than an employee. Workers have rights inter alia to the national minimum and living wage, holiday pay and rest breaks, auto-enrolment and discrimination protection, although the provisions setting out these rights are scattered in different acts and regulations, with slightly varying wording and outcomes.

Recommendation

17. Given the proliferation of definitions, we suggest that the review considers whether definitions of employee, worker and self-employed trader could be harmonised across all the rules that affect employment, for example, tax, NIC, employment rights, pensions including auto-enrolment, health and safety, and social security benefits.

Tax rates

18. Employment is taxed at much higher rates than self-employment. The difference is largely attributable to NIC rates, employees paying Class 1 NICs at 12% while the self-employed currently pay a flat rate Class 2 NICs of £2.80 per week and Class 4 NICs at 9%. Employers' Class 1 and Class 1A NICs at an additional 13.8% is a considerable extra cost for employers.
19. Recent surveys indicate that working practices are changing as workers move from employment to self-employment and 'worker' status, and that this could impact on the UK tax base as NIC receipts fall.

Recommendations

20. More work is needed to understand the financial implications of this move. An informed public debate is needed to explore the difference in NIC rates paid by the employed on the one hand and the self-employed and self-employed 'workers' on the other, whether such a difference continues to be justified, and if so, what this difference should be.
21. Nevertheless, we believe that any review that does not take account of the tax incentives to move people away from employment is unlikely to resolve the problems that exist in other areas, and accordingly we recommend that this be in some manner duly noted. The incentive to game the system, with an employer's NIC rate of 13.8%, apprenticeship levy of 0.5% for larger employers, and employer pension obligations, with whole businesses that exist for no purpose other than to engage people for work, is simply too strong to allow other factors to prevail.

NIC lower earnings limit and entitlement to State benefits

22. An individual's entitlement to State pension and contributory social security benefits is dependent on the NIC record.
23. The NIC lower earnings limit (LEL) is currently £112 per week, so that if an employee is paid below this by an employer, neither employee nor employer Class 1 NICs are payable and no benefit entitlements are earned. Significantly, the earnings from multiple employments are not aggregated. Consequently, a worker with several unrelated, part-time, concurrent employments may be working full-time, but not paying NICs, so not accumulating qualifying weeks on their NIC record. This may reduce their State pension and/or social security benefit entitlements in due course.
24. The NIC LEL also acts as a baseline for measuring entitlement to SSP, SMP, etc for employed earners, while entitlement to Employment and Support Allowance (ESA) and full-rate Maternity Allowance for the self-employed depend on the payment of Class 2 contributions, be they compulsory or voluntary. This is set to change in 2018 when Class 2 is abolished.

Recommendation

25. One solution would be to collect NICs across all concurrent different part-time jobs being worked by an individual when assessing entitlement to state pension and contributory social security benefits. The OTS recently recommended such a plan, but it was rejected due to complexity, to there being too many potential winners and losers (ie, among the electorate), and to the upheaval to HMRC and employers' systems for no material Exchequer benefit. We would suggest that any holistic review should encompass this issue.

Headcounts and tax reliefs

26. Many organisations, particularly in the public sector, and companies use headcounts as a key indicator. Seeking to keep this low may lead to a preference for people to be self-employed or workers.
27. Also, the number of employees that a company has is a condition for many business tax reliefs. For example, seed enterprise investment scheme relief is only available to companies with fewer than 25 employees; small companies research and development tax relief is more generous than the equivalent relief for large companies. Neither of these reliefs is available to the self-employed businessman or woman.

Recommendation

28. Following Brexit, reliefs which would previously have been constrained by State Aid rules could possibly be reviewed. We recommend that close attention is paid to the behavioural consequences of targeting tax reliefs by reference to employee headcounts where this may promote self-employment unless that is intended or irrelevant. Corporate reporting requirements that apply above a certain number of employees may also be relevant.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <http://www.icaew.com/-/media/corporate/files/technical/tax/tax-news/taxguides/taxguide-0499.ashx>).