KPMG response to the consultation on employment status

Employment law rights & taxation

KPMG LLP
1 June 2018

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We respond to this consultation in our capacity as professional advisors, and share our knowledge across a range of expertise including employment law, employment tax and VAT. Our employment law response is in section 1 (Employment Law Rights). Comments on the tax and social security considerations are addressed in section 2 (Taxation: Employment Tax) and our VAT response is in section 3 (Taxation: VAT).

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1. Employment Law Rights

Response to consultation questions

Chapter 4: Issues with the current employment status regimes

1. Do you agree that the points discussed in this chapter are the main issues with the current employment status system? Are there other issues that should be taken into account?

Employment status has far reaching consequences both now and in the future: it determines employment law rights, tax and social security contributions, as well as pension contributions for retirement, and is one of the most significant legal considerations relevant to the UK's growing flexible workforce. Given the confusion concerning how to determine employment status, its relationship with the tax position and its importance, in our view a strategic overhaul of the law is needed. This overhaul should consider all the implications for the individuals being engaged, and the practical and commercial needs of the engaging employer.

We entirely agree with the Taylor review that the employment statuses should be distinct and unambiguous, and ordinary people and employers should be able to understand the categories with clarity. In our view, this can only be achieved by ensuring the statuses reflect modern working practices, and balance the legal, tax, commercial and operational drivers that determine how businesses define their workforce engagements.

We respond to this consultation in our capacity as professional advisors, and share our knowledge across a range of expertise including employment law, employment tax and VAT. We have prepared our response mindful of business operations and the challenges that arise in a flexible labour market. We are keen that any solution to the issues present in the current employment status system need to be workable in practice and sustainable in the longer term.

Below, we set out a summary of how we consider the employment status system should be revised. We also address the specific consultation questions, but these should be read in the context of this summary response.

a) Consider a binary approach and revise employment rights for casual working relationships

One of the advantages of today's labour market is that businesses can be creative in how they engage their staff, and individuals can control their working patterns, fitting it around other priorities and responsibilities. This is a move away from the traditional "master/servant" model, whereby it is assumed that the employer has all the power in the working relationship, setting the terms of the engagement, and overseeing and controlling the individual while they work. In today's workforce, an individual does not necessarily have to be self-employed to enjoy a degree of independence and autonomy while they work. Similarly, loyalty to one employer has decreasing appeal to many in society who prefer to straddle multiple jobs, or change employer frequently to gain different experience and skills.

The current three-tier system for employment status offers flexibility for both businesses and individuals. However, in our experience the boundaries between both an employee and Limb (b) worker, and a Limb (b) worker and someone who is self-employed have become blurred.

In particular, the distinction between a worker and an employee is small (both in terms of identifying them and the employment rights that apply) and therefore, in our view, there is limited value in retaining a three-limbed test. (In respect of the employment rights which apply, please see section e below.)

For that reason, we believe that consideration should be given to removing the category of "worker", and applying a two-tiered test of employee and self-employed. Typically, although not exclusively, we would expect individuals who meet the "worker" test to be categorised as employees unless there is persuasive evidence to demonstrate that the individual is genuinely self-employed. We set out the advantages of this approach below.

Consistent with this approach, we do not agree that a new category of "dependent contractors" would be helpful as this is a relabelling of Limb (b) workers. In our view, individuals who assume new ways of working do not need to be allocated a separate employment status. The better solution is to acknowledge that working practices have evolved, and attribute appropriate protections, rights and entitlements to reflect flexible and multiple working patterns. To be forward thinking, we need to recognise that working practices have changed and provide a clear framework that reflects modern working relationships.

b) The categories of employee and self-employed are well established

Whilst it is simple to identify the rights which are assigned to a worker, it is conceptually extremely difficult to describe or identify a "worker". Conversely, the distinction between employment and self-employment is well established and in our experience businesses and individuals alike generally understand how to differentiate

these categories applying the current employment status principles. Of course, on occasion it may be more difficult to clearly make a decision on status, but that is to be expected: there will always be a minority of 'grey' or 'borderline' cases. In our view that is preferable to the current system where confusion on the distinction between a worker and the self-employed is common.

The key differentiating factors between employees and the self-employed are personal service and control:

- Personal service is typically required in a self-employed and employed context, but in a genuine self-employed relationship, the individual can substitute the work.
- Control may be present in both categories but one would typically expect greater control in an employment context (i.e. compliance with internal disciplinary and grievance policies, training etc).

c) Consideration should be given to a weighted test

Codification of the main principles outlined in chapter 3 is unlikely to resolve the complexity of determining employment status. The primary and secondary principles are very clear and offer flexible engagement options: it is the application of the individual facts which creates uncertainty, particularly if the hallmarks of a particular employment status are not uniformly met. *Autoclenz Limited v Belcher & Ors [2011] IRLR 820 (SC)* is a good example of how courts and tribunals can reach different conclusions on employment status applying the same tests, (and how that is reported in employment law and tax contexts).

If the current case law principles are codified, it is inevitable that further case law will develop to clarify that legislation. A more helpful codification solution would be to provide a weighted framework which all businesses can apply, which provides an objective assessment against a broad range of status indicators.

The main issue with the primary and secondary principles we apply at present is that they can produce spurious results which do not reflect modern working practices. For example, in a self-employed context, there are scenarios where substitution may be permitted contractually but is impossible in reality, so that one might conclude personal service, which indicates employee or worker status, is required.

If a weighted test is introduced through legislation, it needs to be drafted so that no individual factor is determinative. This proposal is a significant move away from the irreducible minimum of mutuality of obligation, personal service and control. In our view, this change is necessary to reflect modern changes to working arrangements whose status indicators are not always aligned on one particular engagement model.

A weighted test should consider both the main three factors, as well as supporting status indicators, such as exclusivity, financial risk and integration, to provide a rounded assessment. We anticipate that a weighted test approach would make categorisation much simpler, removing subjectivity, and providing certainty even when the indicators do not sit neatly on each status category.

We understand from our colleagues in KPMG Germany that the weighted social security employment status test described at paragraph 6.7 of the Consultation works well in practice, as the test is simple and straightforward. However, we understand anecdotally that there are of course challenges with this approach: we will need to devise a weighted test very carefully to avoid deliberate manipulation of engagement models to meet the objective criteria, and to limit the difference between agreement terms and what happens in reality. But overall, we think this is best solution in the current context.

Our ambition for the weighted test would be to ensure that it is simple and quick to apply in practice. We anticipate that it should be possible to limit the number of questions / factors for consideration so that in the weighted test can be completed promptly.

It would be helpful to produce an online status indicator tool which applies the weighted test, using a minimal number of questions as proposed above. Such a tool should be non-binding on the individual / business but should carry evidential weight in the event of a dispute. The advantage of the online tool is that it would provide clear indications of status, enabling individuals as well as businesses to assess their employment status applying the same criteria.

It might be sensible to introduce mandatory (or recommended) requirements for businesses to use the online tool test and issue the reason for a particular employment status to the individual at the start of the engagement, so that if there are any disparities in opinion, these can be addressed and resolved as soon as possible. It would also be helpful to provide supporting guidance to explain how to apply the test in practice.

d) Employees can be flexible

The Taylor Review recommends a shift away from the “lower bar” test for workers, focusing instead on the hallmarks of a casual, independent relationship. This seems to reflect a common assumption that “worker” status is needed to offer two-sided flexibility for casual labour.

However, there are many ways that employees can work flexibly and this needs to be recognised as a potential solution to contractual casual labour as working

arrangements adapt to modern technology and the demands of balancing work and home life. For example, under zero hours contracts, employees can work on short assignments, with no overarching employment in place between assignments. Bank arrangements offer individuals flexibility to pick when they are willing to work, but guarantees them employment protection during those periods of work. We are mindful of the criticism of zero hours contracts, but believe that the new legislation banning the worst aspects of them, together with better protection for casual workers, can enable "employment" to be flexible and provide protection for casual employees.

In our view, with this potential solution, flexibility does not need to be one-sided with individuals absorbing all the risk. It can be a valuable part of an employment relationship, fostering loyalty and improving job satisfaction. Employers are becoming increasingly creative in offering flexible working conditions, allowing employees to work from home, flexi or part-time hours and there is of course the option of making flexible working requests during the employment if the employee needs to change their working patterns.

Of course, a flexible working arrangement can be achieved on a self-employed basis too, but in our view there is an expectation that this type of engagement is the only solution to flexibility, which we do not believe to be the case.

e) Workers already enjoy day 1 rights

Given that workers are already entitled to "day 1" rights afforded to employees, the main difference between worker and employee rights are those which are linked to continuity of service. Therefore, the employment rights currently enjoyed by workers would be broadly similar if they were categorised as employees. Employers might be concerned about increased costs as employees are eligible for family friendly rights, such as maternity and paternity leave but the majority of this cost can be reclaimed.
The subject of continuous service is addressed in the Consultation on measures to increase transparency in the UK labour market, and we will respond to this separately. In summary, we believe that the rules concerning continuity of service could be greatly improved so that individuals who work flexibly with regularity could benefit from the more generous employment protection which is typically reserved for employees with extended continuity of service and who are "permanent" with set working hours. If the rules on continuity of service are revised, this could provide better protection for casual workers/employees who work flexibly but work on a regular basis with the same employer over a protracted period, whilst those who work ad hoc would be entitled to day 1 rights only. This goes to the heart of providing certainty and flexibility for the individual and the employer, and adapting employment protection for the modern labour market.

f) Combined review of employment law and employment tax

A review of employment status will have limited success if it focuses on employment law tests only.

A legal evaluation of employment status in the modern labour market needs to be supported by a long-term employment taxes strategy, which enables alignment and consistency. We therefore urge the government to broaden the scope of the review to include income tax and National Insurance Contribution ('NIC') considerations. Currently there is a misalignment which can produce counterintuitive results. See, for example, *Autoclenz Ltd v Belcher*, in which the individuals concerned were considered self-employed by HMRC, whilst the Supreme Court concluded they were employees for employment law purposes. A concurrent review of the tax and legal regimes is needed to find a solution which can be applied consistently and clearly.

For the sake of completeness, we would also urge a review of the VAT system, particularly in relation to the status of agency and gig workers, as this has been in debate for over 20 years. Consideration is needed on whether these workers are considered to be supplied on an agent or principal purpose for VAT purposes. It is our view that clarity should be given to the VAT position and a set of rules issued against which businesses could abide by in providing temporary staff and/or engaging temporary workers, so that there is consistency amongst businesses. Please refer to section 3 (Taxation: VAT) for further details.

g) Review the income tax and NIC regimes

Tax and social security costs will be key drivers for some businesses when determining how labour is engaged, as they will have significant cost implications for both the engager and the individual. In particular, the Employer's NIC charge (at a rate of 13.8%) remains a significant distortion between the taxation of employed and self-employed earnings.

If the tax and social security distinctions between employees, workers (if applicable) and the self-employed were reduced (and the distortive effect of Employer's NIC removed), we believe that this would effectively remove a significant part of the financial motivation for mis-categorising employees (or workers) as self-employed and/or engagers adapting their business models to minimise the tax and NIC costs.

We elaborate on this point in our comments on the income tax and social security position in section 2 (Taxation: Employment Tax).

h) Align legal employment status tests with IR35

The majority of the Consultation is focused on employment status of individuals in a personal capacity, although in practice, many individuals are supplied through a personal service company ("PSC"). Whilst this is a legitimate engagement option, the IR35 rules highlight that, but for the intermediary employing entity, individuals supplied through a PSC could be considered employees from a tax perspective. Whilst we do not want to encourage setting aside valid contractual arrangements, there is a disconnect between the legal and tax position which is unsatisfactory. To address this, we propose that any update to the status tests should be applied to individuals supplied through PSCs, ignoring the corporate vehicle, so that the assessment can determine the reality of the working relationship.

i) Provide advice and guidance to individuals and businesses

The employment status landscape is unclear and difficult for individuals to understand and interpret. Added to this, individuals typically have minimal bargaining power to negotiate the engagement model with the engager who usually assigns the relevant employment status.

The majority of businesses aim to engage their workforce in accordance with the relevant legal principles but struggle given the current complexity. Once status has been simplified, an online status indicator tool together with guidance should be issued so that businesses can apply the new status categories with ease, and individuals can understand what their status is, and how this affects their rights and entitlements in relation to their employment.

j) Offer streamlined dispute resolution

Challenges to employment status are typically raised after the engagement has begun, as individuals seek employment rights linked to worker or employee status. If employment status was conceptually simple, it would be more difficult for businesses to offer inappropriate engagement options, and it would be easier for individuals to assert themselves at the outset of the engagement, without requiring professional guidance or support.

Although individuals can challenge their employment status informally with the engaging entity, and dispute their status formally at tribunal, this does not necessarily prevent inappropriate engagement models. Claims can be settled or appealed, so that businesses can continue to operate over lengthy periods without making any changes to the engagement approach.

One approach might be to require businesses to confirm in writing what the individual's employment status is at the outset of the employment relationship. The business could confirm the tests which it had applied to determine the status, as well

as an explanation on how this affects the employment relationship (for example, pay, tax, control etc). If the individual disagrees with the assessment, they should be given an opportunity to respond within an agreed timeframe (for example, 4 weeks), and if the parties cannot resolve the dispute, the challenge could be registered with a specific authority for investigation. The aim of this process should be for the dispute to be resolved as quickly as possible. If the business engages in multiple status disputes, this could be highlighted and fines could be considered.

Chapter 5: Legislating the current employment status tests

2. Would codification of the main principles – discussed in chapter 3 – strike the right balance between certainty and flexibility for individuals and businesses if they were put into legislation? Why / Why not?

Codification of the main principles outlined in chapter 3 is unlikely to resolve the complexity of determining employment status. The primary and secondary principles are very clear and offer flexible engagement options: it is the application of the individual facts which creates uncertainty. Codification as proposed in the Consultation does not offer businesses a practical solution: we anticipate that if the current principles are codified, this is unlikely to change the way that businesses assess employment status, or provide any support to individuals who wish to challenge their status.

It is for this reason we have proposed that legislative change should be limited to the introduction of a weighted test which considers a wider range of factors. This is our preferred approach as it would help to provide a more balanced assessment of employment status, reduce confusion and limit miscategorisation far more effectively than codification of existing principles. It is also attractive because it offers a practical tool for businesses to work through, which should give them a definitive and reliable assessment of employment status (assuming the questions have been answered honestly).

Businesses typically determine the employment status of their workforce, advertising roles on an employee, worker or contractor basis. In addition, the engaging entity usually has the greatest power in determining the engagement terms. Miscategorisation might be reduced if businesses were held accountable and faced financial penalties without working through a tribunal case system.

If legislation is introduced, it could invoke penalties for businesses who miscategorise their workforce, for both one-off and multiple cases. However, this would only be appropriate if the legislation can bring far greater clarity, so that businesses are penalised for deliberate rather than mistaken miscategorisation. It would also need to be shown that the business, rather than the individual, determined the employment status. This might be evidenced by the engaging entity requiring the individual to set up a PSC before agreeing to engage them, for example, or offering terms for one employment status only.

It is well known that particularly amongst the higher skilled and well paid, working on a self-employed basis usually offers financial benefits, such as a higher rate of pay and reduced taxation. Individuals also need to be accountable for their status choices, and fines and penalties should also be introduced where individuals assign themselves an inappropriate status.

3. What level of codification do you think would best achieve greater clarity and transparency on employment status for i) individuals and ii) businesses – full codification of the case law, or an alternative way?

See (2) above

4. Is codification relevant for both rights and/or tax?

See (2) above

5. Should the key factors in the irreducible minimum be the main principles codified into primary legislation?

Should the main principles be codified into primary legislation, the key factors of mutuality of obligation, personal service and control should be the main principles to be applied as these are the bedrock of the employment status test. They will need to be considered alongside other tests such as financial risk, exclusivity, integration etc. to ensure a full analysis is undertaken.

6. What does mutuality of obligation mean in the modern labour market?

Historically, mutuality of obligation has been defined as the obligation on an employer to provide work and the obligation on an individual to accept that work. Case law has highlighted that mutuality of obligation essentially indicates whether a contract exists between an engaging entity and the individual. For this reason, it does not substantially support the differentiation between self-employed individual, worker and employee, as a contract of sorts is required in each of these engagement scenarios.

In addition, as highlighted by the Consultation at 5.14, there are scenarios where the obligation between the parties is one-sided, or the arrangement is so flexible that there is no obligation between the parties to accept or offer work. However, once the work has been accepted, there is mutuality of obligation on both sides, even if it relates to a very short period.

As indicated in paragraph 5.12 of the Consultation, mutuality of obligation is often more critical to the concept of continuous employment than employment status. For example, an umbrella contract might describe periods in which the individual is employed, interspersed by periods when there is no obligation between the parties, on the understanding that the employment is not continuous. The same type of contract may be

drafted (whether intentionally or not) to create overarching employment throughout the period of the contract. This distinction is helpful as it highlights how employers can engage employees flexibly and manage the rights and entitlements which attach to the employment.

7. Should mutuality of obligation still be relevant to determine an employee's entitlement to full employment rights?

Mutuality of obligation should still be relevant to employment status tests. It evidences the fact that an employment contract is in place between the employer and employee and is key to consideration of continuity of employment and eligibility to employment rights, but it is not the most important factor.

Should the Consultation on measures to increase transparency in the UK labour market (the "Transparency Consultation") result in changes to the periods which break continuity of service, mutuality of obligation may have even greater importance, particularly in relation to flexible working patterns.

8. If so, how could the concept of mutuality of obligation be set out in legislation?

We do not propose drafting legislation as part of this response. However, we consider that the concept of mutuality of obligation should include the following:

a) An overarching definition stating that it is the obligation on an employer to provide work and the obligation on an individual to accept that work;
b) Clarification that whilst a contract might provide a framework for a working arrangement, mutuality of obligation may only apply during periods when the employer must provide work and the individual must accept the work.
c) Detail on how mutuality of obligation will operate in relation to any proposed changes to the period(s) which break(s) continuity of service, as proposed in the Transparency Consultation.

9. What does personal service mean in the modern labour market?

The phrase "people buy people" is well known and rings true in many employment scenarios in today's labour market. In an environment where personal branding is paramount, profiles are updated and advertised through social media, and reviews on performance are requested and published, personal service is key.

Personal service is not limited to an employment relationship: even where an individual is self-employed, and providing a service to a client or customer, in many instances the expectation is that the individual engaged will perform the service. Therefore, in many instances the "personal" element of service exists in both a contract of service and a contract for services.

Contractually, attempts may be made to create the appearance that personal service is not required. This is often unconvincing because:

a) There is never any evidence of substitution; and/or
b) Substitution is impractical and therefore there is no realistic opportunity to provide a substitute.

Whether a substitution clause is genuine or not often forms a critical part of an employment status assessment, but for the reasons stated above, it is often seldom used in practice.

We acknowledge that substitution clauses will continue to be used even if they might never be adopted in practice. This is in part why we think a weighted test would be a sensible solution, as it looks at the employment relationship in the round so that evidence of a substitution clause would not necessarily prevent finding of employee (or worker) status.

10. Should personal service still be relevant to determine an employee's entitlement to full employment rights?

Yes, personal service is relevant to determine an employee's status and their corresponding employment rights as part of the broader employment status test. Please refer to 9 above.

11. If so, how could the concept of personal service be set out in legislation?

The concept of personal service could be clarified as follows:

- Personal service arises where an individual undertakes in a contract to personally perform work or services.

- If the individual has a contractual unfettered right to employ a substitute, there is no obligation to provide personal service.

- A substitution clause may only be included in the contract with the prior agreement between the parties that it can/will be implemented in practice during the period of the engagement.

- The substitution clause should be drawn to the individual's attention before the contract may be signed, and specific consent to substitution must be given by the individual in a side letter to the contract.

- If practicable, the parties must specify at least one occasion at the outset of the working arrangement in which the substitution will be implemented, and confirm who will pay the substitute.

- The parties must agree whether the substitution is a fettered or unfettered right.
- Evidence of substitution during the engagement should be recorded.

12. What does control mean in the modern labour market?

Control is an important aspect of the employment status test because it is very closely linked to the question of whether an individual is working in business on their own account.

If an individual is providing a service to a customer or client, they will usually negotiate the terms of the engagement, and not be subject to the employing entity's control, in terms of supervision, the specific working time or working approach. However, in today's environment of increasing regulation and compliance, it is acknowledged that even in a self-employed context, a degree of control is often necessary, particularly for regulatory reasons. Where an individual is subject to control beyond pure regulatory compliance, this typically suggests that they are at least a worker, if not an employee.

Whilst we accept that there may be a degree of autonomy for particularly highly skilled individuals, when the employment relationship is considered in the round, it is usually possible to determine whether the level of control is consistent with employee or self-employed status.

The signifiers of control include:

- The employing entity setting the terms of the engagement contract with minimal, if any, negotiation by the engaged individual, including the days to be worked, where the work must be performed, and the scope of the work;
- Supervision and direction of the work;
- Compliance with internal policies and procedures;
- Compliance with disciplinary procedures.

13. Should control still be relevant to determine an employee's entitlement to full employment rights?

Yes, control should still be relevant to determine an employee's entitlement to full employment rights. If necessary, it might be sensible to differentiate between regulatory control which is mandatory for any labour engagement, and "control" which is linked to direction and supervision more typical in an employment/worker arrangement.

14. If so, how can the concept of control be set out in legislation?

As above, we do not propose to draft legislation in this response, particularly as we do not consider codification to be the appropriate solution.

The concept of control could be explained in guidance, differentiating between mandatory control for regulatory compliance and control which is attributable to an employee/worker relationship. Evidence that an employer has control over an employee might include the following:

- Minimal negotiation of the contractual terms.
- Specified place of work, working days and hours.
- Day-to-day direction by the employer
- Compliance required with rules and policies relating to employees (including disciplinary policies)
- Appraisal of work, and inclusion in performance ratings linked to pay and performance improvement plans
- Provision of equipment
- Uniform / branding / cultural approach

15. Should financial risk be included in legislation when determining if someone is an employee?

Financial risk is relevant but should not be imposed on employees. It is a strong indicator of self-employment, although the level of financial risk an individual might assume will differ across roles and industries.

There may be situations where an unscrupulous employer imposes financial risk on an individual to save employment cost and limit its own financial risk, and use this as evidence to disguise employment as self-employment. Therefore, any test for financial risk assumed by the individual should be included in legislation with caution and should not be determinative.

16. Should 'part and parcel' or 'integral part' of the business be included in legislation when determining if someone is an employee?

This test is a helpful consideration, as it separates individuals who are genuinely providing services to the engager from those who are employed. Therefore it would be beneficial to include this concept when determining if someone is an employee.

If this test is included in legislation, examples of what constitutes being part and parcel of a business will need to be provided (we suggest through supporting guidance). These might include an individual:

- performing work which is substantially similar to that performed by employees;
- assuming a line management position for employees;
- being subject to the employer's disciplinary and grievance procedures;

- being offered benefits and bonuses consistent with employees;
- having contact information such as email and telephone numbers consistent with employees;
- being invited to social events.

This test is particularly useful when employment status is considered after an individual has been engaged by the same employer over a protracted period of time and their status may have changed.

In industries where the majority of the workforce is engaged on a contractor or worker basis, this test is challenging, because it almost assumes that to be part and parcel of a business, an individual must be an employee.

Workforces are being set up where almost everyone is self employed and so the traditional concept of integration may on some occasions have less weight. Where there is a mixed workforce of employees and workers or self-employed contractors, it might be easier to apply and interpret how integration impacts on status.

17. Should the provision of equipment be included in legislation when determining if someone is an employee?

The provision of equipment by an employer is indicative of an employment relationship and therefore would be a beneficial supporting factor to be included in a legislative test. However, as technology develops, it is possible that employees will seek to use their own equipment to support their work (for example, use their own tablets, telephones or other electronic devices), and this should not negate their employment status.

Therefore, inclusion of this test in legislation needs to be carefully considered. It may be helpful to distinguish between allowing / encouraging an individual to use their own equipment (which could support several employment status categories), and requiring them to do so (which would point towards self-employment).

Unscrupulous businesses might seek to avoid employment status and business cost by requiring individuals to purchase their own equipment. Therefore it might be helpful to consider when the individual purchased their equipment, and for what other purposes it has been used. Of course, there may be scenarios where the individual is required to purchase specific new equipment before services can be provided, and this would not negate a genuinely self-employed individual's status.

18. Should 'intention' be included in legislation when determining if someone is an employee in uncertain cases?

The intention of the parties could certainly be relevant, but only with caution, particularly where there is a disparity in the bargaining position of the parties.

The issues with this test are that:

- it is possible that both or one of the parties deliberately intend to miscategorise the individual's status to disguise the reality of the relationship;
- the intention of the parties at the outset of the relationship may reflect a different employment status to that in question at the time of any challenge, as employment arrangements change over time.

Therefore, consistently with current case law, it should be considered whether the intention of the parties is a sham, and the relative bargaining position needs to be taken into account, as the individual's intention may be influenced by the employing entity.

19. Are there any other factors that should be included in primary legislation when determining if someone is an employee? And what are the benefits or risks of doing so?

Other factors which are helpful indicators of self-employment include:

- Exclusivity; and
- Length of the engagement

We recommend that these are not ignored, particularly given the increasing number of individuals who work for multiple employers. Exclusivity can be subject to prior approval (typically resonant with employment relationships) or individuals can be free to engage as they please (indicative of self employment).

The length of the engagement can be a helpful indicator, with self employment usually being evidenced by engagements linked with completing a task or a project over a fixed period.

20. If government decided to codify the main principles in primary legislation, would secondary legislation: i) be required to provide further detail on top of the main principles; and ii) provide sufficient flexibility to adapt to future changes in working practices?

As indicated above, we do not consider that codification of the main principles in primary legislation is necessary to address the confusion currently present when determining employment status. We propose instead that a statutory weighted test would be a more practical alternative. Please refer to our response at 1(c) for further details.

21. Would the benefits of this approach be outweighed by the risk of individuals and businesses potentially needing to familiarise themselves with frequent changes to legislation?

The principles and supporting factors have not changed significantly since the Ready Mixed Concrete case: it is the introduction of the category of "worker" and the nuanced application of the principles and supporting factors to three categories whose boundaries have become increasingly blurred, which has made employment status uncertain and complex. Legislating primary and/or secondary legislation does not address any of these issues, but merely codifies the existing framework which is notoriously difficult to apply and balance in practice.

Chapter 6: A better employment status test?

22. Should a statutory employment status test use objective criteria rather than the existing tests? What objective criteria could be suitable for this type of test?

The introduction of objective criteria which can be routinely worked through should offer consistency of approach and remove the scope for subjectivity. In our view, the objective analysis will need to be weighted, with no single factor having a determinative effect.

It might be helpful to list the main employment status tests (mutuality of obligation, personal service, control) and give 2-3 objective questions against each of these to see whether they give a definitive answer. If not, then additional questions addressing supporting factors could be posed.

Objective criteria which might be suitable include:

Mutuality of obligation
- Does the individual have a contract of employment?
- Does the individual have to accept the work once they have agreed to do it?

Personal service (see also comments at question 11 above)
- Can the individual provide a substitute without restriction?
- Has a substitute ever been provided?
- Does the individual pay the substitute?

Control
- Does the individual have prescribed hours and days of work?
- Is the individual subject to supervision from a line manager?
- Is the individual subject to disciplinary and internal policies and procedures?
- Does the individual receive training from the employer?

Exclusivity
- Is the individual only working for the engaging party?
- Can the individual work for other employers without any restriction?

- Is the individual presented to the public / colleagues as a member of staff or a self-employed contractor?

Equipment
- Is the individual obliged to provide their own equipment?

Integration
- Must the individual wear a uniform?
- Does the individual have any line management responsibility?
- Does the individual perform work which is similar to those performed by employees?

Financial risk:
- Has the individual negotiated their own fee / rate of payment?
- Is the individual paid a standard rate or is there any financial incentive built into the engagement?
- Does the individual issue invoices prior to payment?

The reason that the weighted test is preferable to the proposed codification of the primary and secondary principles is that instead of providing a framework of criteria which support interpretation of employment status, the weighted test offers a The introduction of objective criteria which can be routinely worked through should offer consistency of approach and remove the scope for subjectivity. In our view, the objective analysis will need to take to be weighted, with no single factor having a determinative effect.

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- Does the individual pay the substitute?

Control
- Does the individual have prescribed hours and days of work?

- Is the individual subject to supervision from a line manager?
- Is the individual subject to disciplinary and internal policies and procedures?
- Does the individual receive training from the employer?

Exclusivity
- Is the individual only working for the engaging party?
- Can the individual work for other employers without any restriction?
- Is the individual presented to the public / colleagues as a member of staff or a self-employed contractor?

Equipment
- Is the individual obliged to provide their own equipment?

Integration
- Must the individual wear a uniform?
- Does the individual have any line management responsibility?
- Does the individual perform work which is similar to those performed by employees?

Financial risk:
- Has the individual negotiated their own fee / rate of payment?
- Is the individual paid a standard rate or is there any financial incentive built into the engagement?
- Does the individual issue invoices prior to payment?

The reason that the weighted test is preferable to the proposed codification of the primary and secondary principles is that instead of providing a framework of criteria which support interpretation of employment status, the weighted test offers a practical solution which can provide a definitive and reliable assessment. The weighted test has the potential to provide clarity and simplicity to an area which has been complex and confusing.

23. What is your experience of other tests, such as the Statutory Residence Test (SRT)? What works well, and what are their drawbacks?

Please refer to section 2 (Taxation: Employment Tax).

24. How could a new statutory employment status test be structured?

For the reasons above, we propose that a weighted test would be a better solution. Please also refer to question 1.

25. What is your experience of tests, such as the Agency Legislation tests for tax, and how these have worked in practice? What works well about these tests in practice, and what are their drawbacks?

Please refer to question 23 above.

26. Should a new employment status test be a less complex version of the current framework?

We prefer a weighted status test. Please refer to question 1.

27. Do you think a very simple objective or mechanical test would have perverse incentives for businesses and individuals? Could these concerns be mitigated? If so, how?

Please refer to question 23 above.

28. Are there alternative ways, rather than legislative change, that would better achieve greater clarity and certainty for the employment status regimes (for example, an online tool)?

We agree that a technology solution developed by the relevant Government departments to assess employment status would be useful to engagers and providers of labour. Please also refer to question 1 and 22 above and section 2 (Taxation: Employment Tax).

29. Given the current differences in the way that the employed and the self employed are taxed, should the boundary be based on something other than when an individual is an employee?

Please refer to section 2 (Taxation: Employment Tax).

Chapter 7: The worker employment status for employment rights

30. Do you agree with the review's conclusion that an intermediate category providing those in less certain casual, independent relationships with a more limited set of key employment rights remains helpful?

We agree that those engaged in less certain and casual and independent relationships should be granted key employment rights, but this could be achieved through a two-tier employment status system, granting anyone who is not providing services in a self-employed capacity with rights currently enjoyed by employees.

Although the day 1 protection afforded to workers is fairly comprehensive, individuals who should receive worker rights do not always get them because they are categorised as self employed. The intermediate category can facilitate and legitimise miscategorisation, and enables employers to offer limited rights to some of the lowest paid and vulnerable working

population. There is no reason why casual engagements cannot be implemented on an employed basis and benefit from the day 1 employment rights which attach.

Individuals engaged on a casual basis can be vulnerable because they face uncertainty on their working patterns, but this is almost inevitable where work is genuinely flexible. Perhaps the focus should be to encourage employers to forecast flexible work so that they can give more notice on the start and end date, and offer longer engagements (which may have breaks) to give the individual certainty on their working patterns. This may not always be practical and so we do not propose that any mandatory rules should be introduced in this regard.

We do agree that a premium minimum wage rate for those on zero-hours contracts might give individuals better working terms. This move could also encourage businesses to review whether zero-hours contracts are the most suitable engagement model, with some moving to more permanent (albeit flexible) engagement arrangements that offer certainty to the individual. As mentioned elsewhere in this Consultation, proposed changes to breaks in continuity of service proposed by the Transparency Consultation may provide better protection for those in casual employment.

31. Do you agree with the review's conclusion that the statutory definition of worker is confusing because it includes both employees and Limb (b) workers?

We agree that the statutory definition is confusing by including both employees and Limb (b) workers.

However, the inclusion of "employees" is not the primary reason for confusion on the meaning of Limb (b) workers. It is the definition of a "worker" which is challenging.

Some employers may try to categorise individuals as self-employed as they are worried about the close link between workers and employees, and the associated employment protection.

The concept of a Limb (b) worker seems to have become a bucket for individuals who are not obviously employees or self-employed. In practice, it seems rare that a worker would be identified by starting with the statutory definition. The more likely approach would be through a comparative assessment against the two other categories.

32. If so, should the definition of worker be changed to encompass only Limb (b) workers?

In our view, the definition does not need to be changed to just include Limb (b) workers, as it is not the definition of an employee which is the main reason for the confusion. If

retained, the definition of a Limb (b) worker needs to more clearly describe the difference between workers, employees and the self-employed

33. If the definition of worker were changed in this way, would this create any unintended consequences on the employee or self-employed categories?

It is difficult to consider the potential consequences of a revised definition before that definition has been drafted. We cannot anticipate any consequences on the other categories, save for statutory references needing to be checked.

34. Do you agree that the government should set a clearer boundary between the employee and worker statuses?

Yes, we agree that if both categories are retained, the boundary between them needs to be much clearer.

35. If you agree that the boundary between the employee and worker statuses should be made clearer: Should the criteria to determine worker status be the same as the criteria to determine the employee status, but with a lower threshold or pass mark? If so, how could this be set out in legislation?

Should the criteria to determine worker status be a selected number of the criteria that is used to determine employee status (i.e. a subset of the employee criteria)? If so, how could this be set out in legislation?

Or, is there an alternative approach that could be considered? If so, how could this be set out in legislation?

As set out above, we think the best approach would be to remove worker status so that anyone who is not genuinely self-employed is treated as an employee and afforded the associated employment rights.

Essentially (i) is the current position. The problem with a lower threshold or pass mark is that unless it is very clear how the criteria should be applied, the definition of worker will remain vague and open to subjectivity.

If there are a set number of criteria which will trigger worker status (ii), this is more likely to produce consistent outcomes. However, as proposed above, it is likely that the criteria will need to be weighted so that, taken in the round, the assessment of the individual's status reflects their status. The main substantive difference between a worker and employee applying the current statutory definition is that a worker does not have a contract of employment. If worker status is to be retained, the definition of a "worker" (or dependent contractor as proposed) needs to be clarified so that there is a clear differentiation both

conceptually and in practice. This will help the application of weighted criteria to produce consistent results.

36. What might the consequences of these approaches be?

Until there is more detail on the proposed changes described in 35 above, it is very difficult to anticipate the consequences.

37. What does mutuality of obligation mean in the modern labour market for a worker?

Please refer to question 6 above. The concept of mutuality is more relevant to continuity than status.

38. Should mutuality of obligation still be relevant to determine worker status?

If worker status is retained as a separate category, mutuality of obligation will need to be considered.

39. If so, how can the concept of mutuality of obligation be set out in legislation?

Please see question 8 above.

40. What does personal service mean in the modern labour market for a worker?

Please refer to question 9 above. The concept of personal service is a standard test which is applied consistently to define status and therefore has the same meaning across engagement types.

41. Should personal service still be a factor to determine worker status?

If worker status is retained as a separate category, personal service will need to be considered.

42. Do you agree with the review's conclusion that the worker definition should place less emphasis on personal service?

We do not agree that the worker definition should place less emphasis on personal service. This is a key part of the definition and can be a critical distinction from self-employment. However, we do think that personal service should not be determinative and other factors need to be considered concurrently.

43. Should we consider clarifying in legislation what personal service encompasses?

As indicated in the Consultation, there is commentary in case law which sets out the parameters of how the concept of personal service should be considered in practice, and we assume legislative clarification would be consistent with case law principles. Therefore we do not consider that legislation is needed to clarify what personal service encompasses.

44. Are there examples of circumstances where a fettered (restricted) right might still be consistent with personal service?

We consider that substitution, whether fettered or unfettered, should be considered inconsistent with employee or worker status.

45. Do you agree with the review's conclusion that there should be more emphasis on control when determining worker status?

Yes – as this is a significant indicator differentiating between self-employed and workers/employees. Please also see question 14.

46. What does control mean in the modern labour market for a worker?

Please refer to question 14 above.

47. Should control still be relevant to determine worker status?

If worker status is retained as a separate category, control will need to be considered.

48. If so, how can the concept of control be set out in legislation?

Please refer to question 14 above.

49. Do you consider that any factors, other than those listed above, for 'in business in their own account' should be used for determining worker status?

We believe that the main question which determines whether someone is self employed or a worker centres around their independence and therefore the concept of being "in business in their own account" is central to the definition. Please see our comments in question 50 below.

50. Do you consider that an individual being in business on their own account should be reflected in legislation to determine worker status? If so, how could this be defined?

The concept of an individual being in "business on their own account" should certainly be clarified in legislation to support determination of status, and may benefit from the application of weighted criteria.

This concept has a broad meaning and in many situations, evidence can be found to support the test even though an individual would more appropriately be described as a worker (or even an employee). One of the problems with today's flexible labour market is that individuals may choose when and where they work, use their own equipment to do that work and be categorised as self-employed but they are not in fact "in business on their own account" and would better fit the mould of a worker.

The definition might include consideration of the following:

- A historical view of the individual's employment status (i.e. in what capacity have they worked in the role in question previously). This would help to identify whether the engaging business has tried to impose an inappropriate employment status.
- Whether the individual has evidence to support they operate an independent business, such as business cards, headed notepaper, a website, LinkedIn or other social media profiles.
- Whether the individual invoices the engaging party.
- Whether the individual must make good any faulty work in his own time.
- What percentage of the individual's work is performed for the engaging entity reviewed over a monthly period.
- Whether the individual can make a loss or profit.
- Whether the individual has negotiated the terms with the engaging party.
- Whether the individual carries the financial risk / provides the equipment.
- Whether the individual has insurance.

Could regulatory requirements be imposed to require self-employed to register centrally / have a minimum set of evidential factors to meet the test (beyond tax)?

51. Are there any other factors (other than those set out above for all the different tests) that should be considered when determining if someone is a worker?

If any of the points addressed above are not covered in the definition of being "in business in their own account", we would recommend considering these separately. One approach which might provide consistency between the legal and tax assessment of status might be to consider whether the individual is subject to the engager's supervision, direction and control. Please refer to paragraph 14 of section 2 (Taxation: Employment Tax).

52. The review has suggested there would be a benefit to renaming the Limb (b) worker category to 'dependent contractor'? Do you agree? Why / Why not?

Linguistically, the concept of a 'dependent contractor' might create even more confusion because it combines a term often used to describe the self-employed with worker status. This could deepen the blurred distinction between these two categories.

We acknowledge that the proposed term aims to provide greater employment protection for those individuals who perform more casual work than employees, but whose independence and flexibility is curbed by their worker status. However, if these individuals could be classified as "workers" as the term is currently understood, it would follow that they would benefit from worker rights and entitlements.

It would be more helpful to outline with worked examples how different working arrangements typically fit into different employment status buckets so that individuals and employers are offered a more level playing field to determine status and the associated employment rights. Please refer to our comments in paragraphs 10 to 12 of section 2 (Taxation: Employment Tax).

Chapter 8: Defining working time

53. If the emerging case law on working time applied to all platform based workers, how might app-based employers adapt their business models as a consequence?

App-based employers might adapt their business models as follows:

- Remove flexibility so that individuals are appointed specific working time periods (or shifts) when they are permitted to check the app and undertake work.
  Employers could even restrict access to the app during non-working time so that there is no scope for workers to claim NMW is payable outside of their contracted hours.
- Require individuals to accept a certain number of jobs within any given period to maximise efficiency.
- Re-categorise the workforce as self-employed to attempt to avoid NMW compliance.
  Require workers to work exclusively for the business during periods of working time (and possibly even outside of their working time), particularly if the individual has flexibility to refuse work.

54. What would the impact be of this on a) employers and b) workers?

The impact of these adaptations are described below.

a) Employers:

Please note that we highlight the potential impacts of any changes to business models below but KPMG, as a Living Wage employer, does not advocate these approaches.

- By removing flexibility on the hours worked, employers can limit the number of workers who would be eligible for NMW during low demand periods, and therefore reduce their potential employment cost.
- Whilst this might be helpful financially, it will potentially make businesses less able to respond to unanticipated peaks in demand.
- Employers may find it more difficult to attract workers who want to work flexibly.
- Employers might face increased challenges on employment status if they re-categorise staff as self-employed. This could entail significant cost in relation to worker rights such as NMW, holiday pay and sick pay.
- The increased cost of paying NMW during periods of working time will need to be factored in and could be passed on to customers. This could reduce the business' custom, and potentially then reduce the number of workers engaged.

b) Workers:

- Workers might not want to work prescribed shifts and could look for work elsewhere.
- Workers may want flexibility to work for several employers at the same time, and their earnings may reduce if they have to work exclusively for one employer, particularly during periods of low demand.
- That said, workers may welcome the guarantee that they will earn at least NMW during all working time, as this will give them certainty on their earnings.

55. How might platform-based employers respond to a requirement to pay the NMW/NLW for work carried out at times of low demand?

Employers are likely to want to limit the potential increased cost of NMW compliance during times of low demand and therefore, they may:

- Limit access to the technology / introduce shifts so that the employer can control when NMW will be payable.
- Reduce pay for work performed in periods of high demand to balance out the increased cost during periods of low demand.
- Introduce exclusivity clauses so that workers cannot earn during low periods through competitors/alternative employment.

As above, KPMG, as a Living Wage employer, does not advocate these approaches.

56. Should government consider any measures to prescribe the circumstances in which the NMW/NLW accrues whilst ensuring fairness for app-based workers?

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The principles for "on-call" workers in Regulations 27 and 32 of the National Minimum Wage Regulations 2015 and the associated case law provide helpful guidance on how to determine whether a worker is available (or required to be available) for the purposes of working, or actually working, taking into account whether the worker is at home or at a place determined by the employer. These principles could be applied to gig workers.
The time work provisions at Regulation 32 are perhaps most relevant, as gig workers tend not to be salaried. The challenge for employers is that any time where the worker is available, and required to be available, at or near a place of work for the purposes of working would be caught, unless the worker is at home. There are obvious ways that this provision could be manipulated by the employer and the worker respectively: the employer could set up the arrangement so that the worker is never under an obligation to be available, the sort of one-sided flexibility that the Taylor Review aims to reduce. If the worker can meet the condition that they are available and required to be available to work, they could make sure they are available away from home.

The government could consider how the concept of "working time" has been approached under Article 2 of the Working Time Directive and the associated case law. Applying the principles of *Feracion de Servicios Privados del sindicato Comisiones Obreras v Tyco Integrated Security SL and another (c-266/14)* and the more recent case of *Thorbjorn Selstad Thue v The Norwegian Government E-19/16*, working time for app based workers might only apply when the individual is at the employer's disposal and the worker is unable to use his time freely and pursue his own commercial or other interests. This would include periods when:

- The individual is required to log in and check the app;
- The employer has issued an update through the app which the individual must read and respond to (i.e. from the time the alert is read and responded to);
- The individual has accepted a job through the app, and the worker is waiting to start the job (and is unable in that time to use his time to do anything else) or is actually doing it. (The reason for clarifying the waiting time is to avoid scenarios where the individual could accept a job far in advance of undertaking the work).

For the avoidance of doubt, it would not include periods when the individual accesses the app without any prompt to do so, or outside of pre-agreed times when the individual is required to check the app.

Given that apps can be accessed at any time of the day or night, it would be sensible to require the employer and worker to pre-agree periods when the worker will be available and willing to work. This will ensure that working time is agreed and transparent between the parties.

Exclusivity, or at least, an agreed minimum number of jobs which must be accepted within a given period might need to be introduced. This should help give confidence that the

employer has a worker who is either working for them or waiting to work for them during periods when NMW is payable. This should also help to avoid workers signing up to multiple employers, and logging on to apps, without any intention of working, but benefiting from NMW from multiple employers.

57. What are the practical features and characteristics of app-based working that could determine the balance of fairness and flexibility, and help define what constitutes 'work' in an easily accessible way?

- Identifying to the individual whenever they log in, whether it is a period in which NMW will be payable.
- Tracking pay during each hour as the individual logs on and undertakes work so that they can see whether they will earn an amount equal to or above NMW.
- Highlighting periods of peak and low demand.

58. How relevant is the ability to pursue other activities while waiting to perform tasks, the ability of workers to refuse work offered without experiencing detriment, requirements for exclusivity, or the provision of tools or materials to carry out tasks?

This section assumes that the individuals engaged are workers. If new provisions concerning working time are introduced, one way to ensure fairness would be to distinguish between the working arrangements which can be offered to self-employed individuals as opposed to workers.

For example, it is arguable that if certain waiting time is construed as working time, then it would not be appropriate for workers to undertake work for different employers: to allow this could allow workers to accrue multiple NMW entitlements, which is not the aim of the legislation. One way to resolve this would be to:

a) introduce exclusivity to the arrangement, so that the worker can only undertake work for one employer at a time;
b) introduce limits on the right to refuse work. Employers are unlikely to want to pay workers during waiting time if they have an unlimited ability to refuse work, particularly if the achievable earnings for accepting work are close to NMW.

When the individual is checking into the app, the qualifying criteria should take into consideration:

- Whether they are under the instruction of the employer. Can the individual use his time freely and pursue his own interests, or is the individual at the employer's disposal whenever they log into the app? Can the individual accept or reject the

job? Must they stay in a particular area while waiting? Can they do other work while being logged on?
- Can the employer cancel, change or add assignments when they are waiting for jobs?

There should be a distinction between workers and self-employed individuals, and the provision of tools and equipment is a key criteria. As workers, the tools and equipment should be provided by the employer, or at least, the cost should be reimbursed by the employer. Self-employed contractors can be expected to provide their own tools and equipment.

There may be exceptions to this, such as mobile phones used to access technology. The employer may need to bear the cost of data roaming charges used to perform the work, but it is unlikely that the actual phone equipment would entail any additional cost for the worker.

59. Do you consider there is potential to make use of the data collected by platforms to ensure that individuals can make informed choices about when to log on to the app and also to ensure fairness in the determination of work for the purposes of NMW/NLW?

Provided that apps are designed so that it is transparent when the high and low demand times are, it should be possible for individuals to make informed choices about when to log on, and when to expect work to be available.

In addition, the employer could introduce a mechanism to prevent individuals from logging on during agreed periods, so that they can only log on during periods of working time (whether that is waiting time or time they are undertaking work).

Chapter 9: Defining 'self-employed' and 'employers'

60. Do you agree that self-employed should not be a formal employment status defined in statute? If not, why?

Currently, whether someone is categorised as self-employed is a subjective assessment, often comparative against an employee. If the definition of a Limb (b) worker can be clarified and the concept of "working in business on the individual's own account" is more specifically defined, then it follows that a definition of self-employment is not required.

Defining the self-employed in legislation may encourage unscrupulous employers to manipulate arrangements so that individuals meet the desired definition, but this is already

a risk and so is not a compelling reason to avoid a statutory definition, particularly if a "worker" will be redefined in legislation.

As part of the statutory definition, it would be helpful to deal with self-employed individuals who set up PSCs to provide an evidential break between the employer and the individual, but who otherwise lack the hallmarks of self-employment. In an employment law context, the contract is typically the starting point for an employment status assessment and it would be unusual for an employment tribunal to look through the contract unless it is a sham. The IR35 legislation gives HMRC the ability to challenge the taxation of money paid to PSCs from an employment tax perspective, but has no impact on the employment law assessment of status.

A PSC is usually attractive to the individual as it helps limit their tax liability in relation to the engagement and provides evidence for employers which demonstrates there is no intention the relationship should be one of employment. If the IR35 legislation is applied consistently in the employment law sphere, whereby the arrangement can be construed as one of employment if the relevant test is met, it is likely that the risk the engaging employer is responsible for employment rights would discourage engagement through PSCs.

61. Would it be beneficial for the government to consider the definition of employer in legislation?

It is rare that there is confusion concerning which entity is the employer where there is direct engagement. Typically, confusion arises where there is more than one entity in the chain but even then, the hirer and supplier are usually identifiable.

It might be helpful for individuals to be provided with additional guidance on who an employer is so that they understand who is responsible for pay and basic rights, but we do not consider legislative clarification is necessary.

Additionally, a section 1 employment contract requires the employer to be identified. Similar provisions could be introduced for worker contracts to ensure there is clarity between the parties on which entity is the employer, and this is considered in separate consultations

62. If the terms employee and self-employed continue to play a part in both the tax and rights systems, should the definitions be aligned? What consequences could this have?

Aligning the definitions of employee and self-employed across tax and employment would certainly support a coordinated approach and reduce the scope for counterintuitive results.

Please refer to section 2 (Taxation: Employment Tax).

63. Do you agree with commentators who propose that employment rights legislation be amended so that those who are deemed to be employees for tax also receive some employment rights? Why/why not?

The use of PSCs has received criticism but for many sole traders, tax is not the key driver for their use: a PSC is a legitimate company vehicle which offers the advantage of limited liability, corporate business branding, and company profiles of director and shareholder. That said, PSCs can be abused and for this reason the employment law position needs to be amended so that those deemed employees for tax purposes receive rights afforded to employees, subject to the following:

- It would not be appropriate to impose a blanket authority to look through contractual arrangements. It would be necessary to have a specific and clear check list of reasons to set aside the arrangement.
- This assumes that but for the company vehicle the individual is provided through, they would be an employee. There may be circumstances where the individual is better described as a worker (assuming the three-tiered approach remains). Specific consideration needs to be given to PSCs as these are very often used to disguise employment or worker status.

If Limb (b) workers are taxed on an employed basis, this could prompt employers to adapt their business models so that they have less tax and NICS to pay, as well as limited employment rights. The way to restrict this potential impact would be to tax the self-employed in a way similar to employees so that there is no tax incentive to miscategorise staff. Please refer to section 2 (Taxation: Employment Tax).

64. If these individuals were granted employment rights, what level of rights (e.g. day 1 worker rights or employee rights) would be most appropriate?

To be consistent with IR35, it follows that these individuals should be given employment rights. If individuals are genuinely employees, they should get the employment rights commensurate with that status.

The question of which rights should be afforded to the individual will only arise if (a) the position is reviewed by HMRC or (b) a claim is brought by the individual to the employment or tax tribunal, so any rights will be applied historically so the application of these rights is in doubt.

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2. Taxation: Employment Tax

KPMG LLP's comments on the tax and social security aspects of the ***Employment Status Consultation*** (February 2018) are set out below. These comments should be read in conjunction with our broader response in section 1 above.

The current consultation and longer term strategy on employment taxes

1 We welcome the Government's decision to consult on clarifying employment status in response to the Taylor review of modern working practices, and to invite comments on certain income tax and National Insurance Contribution (**'NIC'**) considerations.

2 We stated in our response to the consultation's publication that, in our view, the Government should also engage in a wider dialogue on how the UK should tax labour in the 21st century.

3 In particular, we recommend that a broader debate considers how the tax and social security positions can distort how businesses engage labour, particularly the effect of Employer's NIC at 13.8% of payroll costs, which applies to employment but not to self-employment. We also considered what alternative solutions might remove this distortion, e.g. an alternative levy on broader business costs in place of Employer's NIC (see here).

4 This remains our view. We therefore encourage the Government to initiate a broad and thorough debate on a sustainable long term strategy on the taxation of labour once it has had an opportunity to consider responses to the current consultation.

5 It is important that any labour taxes 'road map' to implement such an agreed strategy (and any other changes which result from the current consultation) is based on a realistic timetable for businesses to implement the resulting changes.

6 Our specific comments on the income tax and social security aspects of the consultation are set out below, but should be considered in light of our preference for a broader debate.

Chapter 6: A better employment status test?

Q23. What is your experience of other tests, such as the Statutory Residence Test (SRT)? What works well, and what are their drawbacks?

7 Statutory status tests, such as the SRT, have the advantage of providing certainty which businesses are likely to welcome. However, in our view there are two potential drawbacks.

8 Firstly, the requirement to provide a set of rules that anticipates all foreseeable sets of circumstances that might arise can result in complexity. For example, the SRT[1] contains 159 paragraphs, including those amending other legislation, and HMRC's accompanying guidance extends to more than 100 pages.

[1] Finance Act 2013, Schedule 45.

9 Secondly, not all circumstances which might arise in practice, particularly in a complex and evolving area like working practice, can be foreseen. This could potentially result in a statutory test producing apparently anomalous results where a 'box ticking' exercise is followed.[2] In contrast, the current case law tests do arguably allow a more nuanced approach to the question of employment status.

10 In order to test the design of any prospective statutory employment test, clearly it would need to work effectively in the real world. For example, in relation to (i) cab drivers using an app-based platform to obtain work v drivers working with a more traditional mini-cab firm, (ii) tradesmen, builders, painters & decorators working for an individual/business undertaking work for varying periods of time (days, weeks, months) and (iii) individuals with highly specialised skills in IT, engineering, surveying, architecture and medical consultants. Account would also need to be taken as regards behavioural effects such as adaption of business models to avoid employed status.

11 But before testing any new design we think it will be important to ascertain thinking on how various business relations are presently treated and whether the result is the right one. This was the approach taken in considering whether to introduce a SRT. It involved consideration of *circa* 50 scenarios where the 'exam questions' were two-fold, i.e. (i) what do you think the position is under the ***current*** rules, and (ii) what do you think the position should be under any ***new*** rules? We also recommend this approach here too, possibly as part of a call for evidence - it would provide a check on the degree of consensus around employment status and how the rules presently/should operate.

12 Evidence gathered in this way would shed light on:

- what types of workers might move from being categorised as self-employed under the ***current*** rules to being employed under any ***new*** statutory test (and *vice versa*);
- whether any such changes are intended/unintended and desirable/undesirable as a matter of public policy;
- which factors influence different results in relation to apparently similar working arrangements and whether these are appropriate; and
- Whether/how the results might differ were there to be a change to the relevant business model and whether this may be a likely response. For example, to eliminate 13.8% Employer's NIC and/or to lessen responsibilities under employment law. This being particularly relevant to existing/emerging business in the gig economy.

13 In any event we think any statutory test should build-in flexibility in response to future changes in working practices. Accordingly, this may involve legislating the main factors in primary legislation (at a relatively high level), with more detail in secondary legislation.

Q25. What is your experience of tests, such as the Agency Legislation tests for tax? What works well in practice, and what are their drawbacks?

[2] indeed the SRT can sometimes produce counter-intuitive results in certain cases.

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14 The Agency Legislation at ITEPA 2003, section 44 hinges on the concepts of personal service and supervision, direction or control ('SDC'). Whilst this is succinctly expressed in the legislation it has nevertheless required extensive HMRC guidance/examples to pin down exactly what SDC means. This said, if the category of 'limb (b) workers' is to be retained (see below), one approach may be to base the definition on ITEPA 2003, section 44. At least businesses would then be familiar with the concepts involved, as they are already required to apply them in taxing agency workers.

Q28. Are there alternative ways, rather than legislative change, that would better achieve greater clarity and certainty for the employment status regimes (for example, an online tool)

15 Regardless of whether or not legislative change is considered to be the best way to give greater clarity on employment status, we consider that a technology tool which assists engagers and providers of labour to assess that status is, in principle, useful. Such a tool already exists for tax purposes, i.e. HMRC's Employment Status Indicator, but we think this tool should apply as a guide for employment law purposes as well - particularly, where a single definition of employment is to apply for both tax and employment law (see below).

16 Such a tool would clearly need to be comprehensive and robust in order to command the confidence of all stakeholders.

17 We believe the conclusions reached using such a tool should be binding on HMRC provided all the questions are properly answered and the facts remain the same. This is the position with the existing tool. Equally the engaging parties should remain free to argue for a different result should they wish to do so.

Q29. Given the current differences in the way that the employed and the self-employed are taxed, should the boundary [between those tax regimes] be based on something other than whether an individual is an employee?

18 We are slightly unclear quite what this question is driving at. However, if the current differences in the way the employed and self-employed are taxed are to be retained (and albeit that we would encourage a wider debate on this), we do not see any way of basing the boundary on anything other than whether or not an individual is an employee.

19 This said, should the concept of 'limb (b) worker' also be retained, we do think that the tax position of such individuals is in need of clarification.

20 The Consultation document suggests that most 'limb (b) workers' would currently be taxed as self-employed[3]. However, as 'limb (b) workers' *cannot* carry on a profession or business[4] - which points away from self-employment - we are surprised by this comment as we think that 'limb (b) workers' should generally be classed as employees for tax purposes under the current tests. We would be interested in how HMRC's compliance teams view the position in determining their status in practice for tax purposes.

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[3] *Employment status consultation*, para. 10.5.
[4] *Employment status consultation*, para. 3.8.

21 In any event, it seems to us that the issue of approach/definition around 'limb (b) workers' is one of public policy and we think the tax treatment should follow accordingly. This said, if it is decided to retain 'limb b workers' one outcome might be for employment law to place greater emphasis on a requirement for the engager to have a right of SDC over the manner in which the individual provides his or her services. In other words, a dependency of the individual on the engager that takes his/her position beyond that of self-employment and which should then be taxed as employment.

22 As noted above such a test would be similar to that which currently applies to identify agency workers for income tax purposes under ITEPA 2003, section 44, and would therefore have the advantage of familiarity to businesses.

23 However, we reiterate that as long as there are material differences between the tax costs of engaging labour under self-employment and employment models, there will remain an incentive for businesses to 'game the system' in an attempt to lower operating costs.

24 Indeed it is Employer's NIC (at 13.8%) which introduces the greatest distortion here – this is surely the 'elephant in the room' which really needs to be addressed? To this end we recommend a wider debate to include the potential replacement of Employer's NIC with an alternative levy on broader business costs in order to level the playing field. This would then prevent continued avoidance of Employer's NIC and/or distortion of the labour market by business models being adapted to minimise tax cost.

Chapter 10: Alignment between tax and rights

Q62. If the term employee and self-employed continue to play a part in both the tax and rights systems, should the definitions be aligned? What consequences could this have?

25 The current misalignment between the employment law and income tax rules can produce counterintuitive results. For example, in *Autoclenz Ltd v Belcher*,[5] HMRC apparently concluded that the individuals in question were self-employed,[6] but the Supreme Court held that, for minimum wage and working time purposes, they were working under contracts of employment.[7]

26 A single definition of 'employment' would remove such discrepancies and make it easier for businesses and individuals to identify the rights and comply with the duties that arise from their working relationships.

27 We also recommend that the definition of 'earner' for NIC purposes be closer aligned to that of 'employee' for tax purposes, and that any unnecessary distinctions be removed. In particular, we suggest the Social Security (Categorisation of Earners) Regulations 1978 (SI 1978/1689) be reviewed to confirm whether these distinctions remain relevant in light of current and evolving working practices.

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[5] [2011] UKSC 41, [2011] 4 All ER 745.
[6] [2011] UKSC 41, [2011] 4 All ER 745 [5].
[7] [2011] UKSC 41, [2011] 4 All ER 745 [39]

28 In our view, a single definition of 'employment' should be driven by employment law public policy considerations, with the income tax and NIC applying accordingly once that definition has been agreed.

Q63. Do you agree with commentators who propose that employment rights legislation be amended so that those who are deemed to be employees for tax also receive some employment rights? Why/why not?

29 The IR35 rules provide that individuals who typically own and provide services via their own Personal Service Company ('PSC'), and are not employees of the end-user for employment law purposes, are treated as such for tax purposes where their relationship with the end-user is akin to employer and employee. They were introduced in 2000 as a revenue protection measures. (The same is also true of the more recent rules on 'salaried partners').

30 Although these rules represent a distortion from the contractual position for tax purposes it is likely that they will be retained for the time being because the tax revenues involved are considerable. Indeed the changes to the IR35 rules in the public sector from 6 April 2017 (requiring PAYE/NIC to be accounted for at source), coupled with the recently published consultation in relation to the private sector, underscores this.

31 We comment separately on whether employment rights should be extended in these cases.

32 However, whether the IR35 rules apply to the PSC or they require the engager to account for PAYE/NIC at source, a key tax issue that arises in engaging labour via a PSC, relative to on a self-employed basis, is Employer's NIC at 13.8%. As we have said, this is something which we believe needs to be addressed as part of a broader strategic review to develop a road map for taxing labour in the 21st century.

1 June 2018

3. Taxation: VAT

Our comments on the VAT aspects of the Employment Status Consultation are set out below. These should be read in conjunction with our broader response in section 1 above.

The current consultation and longer term strategy on VAT

1. We welcome the Government's decision to consult on clarifying employment status and the specific focus on the gig economy. For the sake of completeness, we would also urge a review of the VAT system in relation to the provision of temporary workers, including those referred to as gig workers. Where an individual is classified as self-employed, he will be required to register and charge VAT on his supplies, subject to the VAT registration threshold, and subject to normal VAT rules. This is clearly not a requirement where an individual is deemed to be an employee, where the VAT accounting requirement falls onto the employer. In circumstances where there is doubt over employment status, inevitably this leads to doubt about who should be accounting for VAT and on what services.

2. For over 20 years, litigation has continued in relation to the VAT status of what would be classified as more traditional temporary workers such as locum doctors, nurses, secretaries etc. This largely commenced with *Reed Personnel Services Ltd v CCE [1995] STC 588*, and has continued ever since, with current litigation ongoing in the case of *Adecco UK and others v HMRC [2017] UKUT 113*. These cases all look at the worker and employment rights afforded to the temporary workers to determine whether their supply by the "temp agency" is one of agent or principal for VAT purposes. The former requires the worker to consider themselves self-employed and hence (where applicable) account for VAT on their own services, the latter assumes an employment type relationship by the "temp agency" meaning VAT is due by the temp agency on all the income earned in respect of the worker (their salary, plus agency commission).

3. There are also numerous examples where changes in employment rights afforded to workers have allowed HMRC to deem employment status for VAT purposes, and attempt to force temporary agencies into accounting for VAT as a principal. For example, the enactment of The Conduct of Employment Agencies and Employment Businesses Regulations 2003 led to HMRC concluding that these Regulations afforded sufficient employment rights onto "temps" such that they are akin to employees, and the temp agencies must therefore be principals for VAT purposes (and account for VAT as if the agency were an employer).

4. We hold a concern that the same level of confusion and litigation as detailed above in the VAT sphere is leading to difficulties for gig economy businesses. These businesses need (and want) certainty over their cost base, and an additional 20% on their prices or margins can have a significant business impact. A dispute over the employment status of the gig workers inevitably means that there will be a dispute over who accounts for VAT and on

what services supplied. Are the gig workers responsible for their own VAT positions as self-employed individuals, or is the gig business required to subsume the services of its workers into its own charges, count these services as its revenue, and therefore charge 20% on this total value? Without clarity on the worker status, these gig businesses are unlikely to have certainty over their employment costs and their pricing. For some of these businesses, this could result in failure as the model is often low margin high volume.

5. If we want certainty on the tax position, this must therefore include a review of the VAT position and legislation around these temporary workers.

1 June 2018