



Prime Minister

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To note this
interim
report

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Ms 31/3

PRIME MINISTER

SELF-EMPLOYMENT

At a meeting of the Liaison Committee on 10 November 1982, there was some discussion of taxation of the self-employed. Robin Butler's letter of the same date asked for a note on the subject.

2. We start with a firm belief in self-employment. A vigorous small firms sector is a crucial channel for bringing new energy, new enterprise and new initiative into industry and commerce. Self-employment embodies the attitudes we wish to foster. Individual responsibility, hard work and risk taking are a central part of being self-employed.
3. People sometimes talk as if a move into self-employment was almost the same thing as a move into the black economy. Not so, of course - and the suggestion is offensive to many of the self-employed themselves. In practice, both the self-employed and the employed are to be found in the black economy.
4. Our objective is to encourage genuine self-employment. We need to ensure that both self-employment and employment are properly taxed. We must avoid guerrilla warfare between the Revenue and the taxpayer.
5. At present such warfare is conducted on the boundary between employment (Schedule E) and self-employment (Schedule D), and on the boundary between the taxed economy and the black economy.



6. We are under pressure from those who say that these boundaries are inadequately policed. They see this as leading to unfairness and to loss of revenue. Against that we have those who say that the policing is oppressive, costly and destructive of initiative and enterprise.

7. My minute of 18 March described the content of the first report of the Keith Committee on the enforcement procedures of the Revenue departments. In effect Keith lines up alongside a series of comments and recommendations from the PAC on the need to tighten enforcement, and alongside many of the recommendations in the CPRS Report on the black economy. In both the tone and the specific proposals in their 12th Report, 1980-81, and their 22nd Report, 1981-82, the PAC have made clear their view that we need to police both boundaries more rigorously. And the CPRS Report contained a pretty trenchant statement (paragraph 6.6 of its conclusions) of the case against the black economy. It went on to make a series of recommendations designed to improve the effectiveness of enforcement work.

8. I have set out this background because it shows that the pressures on us are by no means all in one direction - though this of course is hardly surprising.

9. What is especially unsatisfactory is that at least part of the problem arises from a genuine lack of clarity about what is legitimate and what is not. This particularly arises on the boundary between Schedules D and E. Uncertainty at the margin can lead to surprise and criticism when the Revenue's view turns out to differ from the individuals'.

10. The problems this causes are magnified as there can be so much at stake. Both "employers" and "employees" can find it very attractive for the "employee" to be treated as self-employed. But the very factors which make Schedule D treatment attractive to the taxpayer involve substantial costs for the Exchequer.



11. Nicholas Ridley and John Wakeham have considered whether we are, in principle, trying to draw the boundary between Schedules D and E in the right place. The present tax rules ask the basic question:

"Are you in business on your own account?
Or are you working for somebody else?"

We think this is about right. We encourage people to move into self-employment precisely because of the virtues of self reliance and enterprise which go with being "in business on your own account".

12. On the face of it there would be great attractions in allowing an individual to choose whether he is to be taxed either under Schedule D or Schedule E. But this would require the tax treatment of the two to be much more in balance. I doubt if we can bring the two schedules entirely into line. The fact is that the Schedule E person - drawing a weekly or monthly pay cheque - is just not in the same position as the self-employed businessman.

13. But what we can and must do is try and resolve the problems caused by the uncertainties of definition at the margin. There is no statutory definition of "employment" or "self-employment" for tax purposes. As elsewhere in the tax system, we have to turn to case law for guidance, and can identify 8 criteria which the Courts have used to help decide whether a taxpayer is or is not "in business on his own account". These are set out in Appendix A. They leave difficult cases at the margin. Hence our problem.

14. We have looked at ways in which we could introduce greater certainty for the citizen. Broadly, these are:

- a. a new statutory definition based on the existing criteria.



- b. a new statutory definition based on some simpler (and perhaps less arduous) test.
- c. a clear re-statement in simple terms of what self-employment under the existing law entails.

A statutory definition based on the existing criteria

15. I do not think anything would be achieved by incorporating into the legislation the criteria at Appendix A.

16. Three reasons. First, the legislation would be long, with extensive definitions of individual words and phrases. Second, many of the conditions would have to be heavily qualified. Third, a whole new body of case law would spring up concerned with the meaning of peripheral phrases such as "control" and "financial risk"; because of these there would still be uncertainty at the margin. We would have achieved nothing - except to make confusion worse confounded.

A statutory definition based on a new test

17. This looks attractive as a way of encouraging enterprise and independence. The problem is to find a new formula which focuses on those who genuinely wish to be enterprising.

18. One possibility would be to define self-employment as involving no entitlement to paid holidays, sick pay, redundancy pay or an occupational pension. It might also be a requirement that the individual shows he has made some provision of his own for some or all of these benefits.

19. But there is a catch. While it is pretty obvious that someone enjoying all these benefits is unlikely to be self-employed, the converse does not follow. Some full-time employees do not enjoy them all. There would be particular difficulties in relation to short term, casual, intermittent or "one off" engagements.



20. The Keith Committee considered the position on casuals, and recommended a scheme which would make their tax treatment more onerous than it is now. We shall be examining this, and whether it could provide a sensible way forward. But I am very conscious that starting afresh with a new definition could lead to more litigation at a new margin - which could mean that it would take years for the rules to settle down.

A clear re-statement of existing law

21. I have been considering a two-pronged attack to reduce uncertainty.

22. First, we could issue a leaflet setting out in clear layman's terms what self-employment entails. This would remove a lot of the mystery. An early draft of such a leaflet is at Appendix B. Clearly more work needs to be done on it; but something along these lines is worth considering.

23. Second, I am exploring the idea of introducing a "mechanism" under which interested parties could seek a binding determination from the Inspector of Taxes of the correct position in advance. Such a determination would have to be made within a set time limit - say 30 days - and would be open to appeal. There would be manpower implications: the Revenue might require 180 staff per 100,000 requests for determination. And we would need primary legislation, in a Finance Bill. The outline of such a scheme is at Appendix C.

24. Obviously we would need to proceed with care - not least because the self-employed would rather have uncertainty than what they would see as the wrong kind of certainty.

Conclusion

25. Our basic objective is to encourage genuine self-employment and to provide an environment in which enterprise can flourish. At the same time we are under pressure, both from those who wish to see tax enforcement strengthened, and from those who wish to see it restrained.



26. Our task is made harder by the genuine uncertainty that exists in certain important areas. Particularly the dividing line between employment and self-employment. It would be right to improve understanding of the present law and to make administration more accessible to the citizen. The proposed leaflet clearance procedure should go some way towards this. Properly handled this should reduce the problems we face of accusations that the Revenue are harrassing the self-employed and small businessmen.

27. Looking further ahead, we shall continue to examine the possibility of finding a simpler and more relaxed definition of self-employment and of dealing with the problems of casuals.

28. This is no more than an interim report on a great deal of current work, in which Nick Ridley, John Wakeham and I are keen to find some worthwhile ways of simplifying the tax system and making it more hospitable to enterprise. The search continues; and any suggestions that you might care to make will be grist to their mill.

(G.H.)

30 March 1983

EMPLOYMENT AND SELF-EMPLOYMENT - NOTE BY INLAND REVENUE

There is no statutory definition of "employment" or "self-employment", although this status is clearly crucial in determining rights and responsibilities in areas which range far beyond taxation; it does, for example, determine rights and duties under the Employment Protection Acts and governs the contributions to be paid and benefits available under the Social Security Acts. The distinction has been extensively considered by the Courts. We have for guidance a considerable body of Case Law, although most are not tax cases but have largely been considering employment status for the purposes of the Social Security and Employment Protection Acts where similar tests have to be applied.

From these judgements we have extracted eight factors to be borne in mind when considering whether a contract is one "of service" or "for services". They are not of equal weight - and in fact the weight can vary from case to case and therefore it is not possible to decide on which side the balance falls by a simple majority, but we think that applying these tests in the light of the Case Law should enable our Inspectors to reach a conclusion which would, if necessarily tested, be approved by the Courts.

- A. Case law has given some considerable weight to control, although this is not conclusive. If the person engaging the services has the right to control the way a task is performed, the time when and place where it is to be done and is able to exercise discipline over the person performing its work, the indications point to employment rather than self-employment.
- B. Although many tradesmen, for example, may provide their own tools, regardless of whether they are employed or self-employed, the provision of equipment of a more substantial nature is an indicator. A person in business on his own account would be expected to provide his own equipment; if major items are provided by the person engaging the services, then this is an indication of possible employment.
- C. An employee is normally required to do himself the task for which he is hired, subject to agreed powers of delegation. If the contractor has the right to choose whether to perform the agreed task himself or to pass it to others, then the indications are of self-employment. Thus the right to engage helpers is a useful test.

- D. An employee normally takes no financial risk. He bears no financial responsibility if the business is unsuccessful and has limited opportunity to arrange matters to maximise his profits. If this risk is present, then it is an indication of self-employment.
- E. The method of payment can be of some limited help. A fixed payment for time is an indication of employment, but payment by commission only is not inconsistent with employment.
- F. If the person engaging the services has the exclusive right to them, this is indicative of employment, particularly when linked with control (A above).
- G. If the person engaging the services can require the work to be done at a particular place, especially if it is his own premises, then it is more likely to be an employment than if the person carrying it out can perform the services wherever he wishes.
- H. An employee will normally have set hours of work and agreed holiday entitlement. If these are absent and the contractor can work what hours he pleases and take time off when he wishes, there are indications that he is self-employed.

None of these tests can be said to be conclusive and some must bear more weight than others. The question to be asked is "Is the person in business on his own account?" This list of tests, taken as a whole, help to answer this question.

SELF-EMPLOYMENTWhat it means to be self-employed

To be self-employed you have to be responsible for paying your own tax and national insurance contributions. [You are an employee if your employer is responsible for deducting your tax and national insurance contributions from your pay]. You have no rights or duties under the Employment Protection Acts. You are liable to the general public for the work you do.

What is self-employed

In addition, to be self-employed you have to be in business on your own account. There is no one simple test, but a number of factors which will indicate whether or not you are in business on your own account. These are:-

You cannot have an entitlement to paid holidays, sick pay, firm's pension rights; or redundancy pay.

You have to be responsible for deciding how the business is run, and take the financial and other decisions, and be responsible for bearing losses as well as taking profits.

You yourself must control the way you do your job, and the time and the place at which you do it. If the person who has engaged your services can control the way you work, the chances are you are an employee.

You must be free to hire others to do the work you have agreed to undertake.

You would most probably have to provide all the equipment (not just the small tools which some employees provide) to do your job.

None of the persons for whom you work can have exclusive rights to your services. [Having a number of jobs with different employers does not make you self-employed]

You should not be paid a fixed payment for a set time but only for the work to be done. (You may still be an employee even if you are paid by commission or on a piece work basis).

You would not normally be required to work set hours and at the premises of the person who is engaging you.

If you disagree with the Inspector's decision you can appeal against your tax assessment and have it adjudicated by the independent Appeal Commissioners.

This statement has no binding force and does not affect a taxpayer's right of appeal on points concerning his liability to tax.

A possible "mechanism" for establishing employed/
self-employed status

1. A person making payments to an individual in return for services (Principal) may seek a certificate from the Inspector (dealing with his PAYE) authorising payment without deduction of tax. The individual providing the services (the Contractor) may apply on his own behalf. See Form of Application.
2. The Inspector on receipt of an application either from the Principal or the Contractor shall within 30 days either (a) issue a certificate showing the name of the person making the payments, the names of the individual receiving them and the nature of the services to which the payments relate; (b) refuse to issue such a certificate; or (c) request further information.
3. A certificate applies to all payments made after the date of the Inspector's certificate or such other date as is specified by the Inspector in the certificate.
4. The certificate authorises the Principal to make payments in full without deduction of tax. It tells the Contractor that he will be treated as liable to tax in respect of the payments in question under Case I (or II) of Schedule D.
5. If the Inspector refuses a certificate either party may appeal, but the other may be required to be joined in proceedings before Commissioners. Tax to be paid on the basis of the Inspector's refusal pending the Commissioners' hearing.
6. If the Inspector "discovers" that the Contractor is an employee the certificate can be revoked immediately - PAYE to be applied thenceforth. Periods up to that date will be properly assessable under Case I of Schedule D. [? cessation rules]

FORM OF APPLICATION

A From the Principal

XYZ works for me as a _____ The terms of his
engagement are (copy of contract enclosed).

Either

- i. I do not know whether XYZ is employed by me.
Please give me a ruling. In the meantime I
am deducting tax.

or

- ii. I believe XYZ is not an employee of mine.
Please confirm this. I am not deducting tax
from payments but I undertake to account for
tax if I am wrong.

B From the Contractor

I work for ABC as a _____ The terms of my
engagement are (copy of contract enclosed).

Either

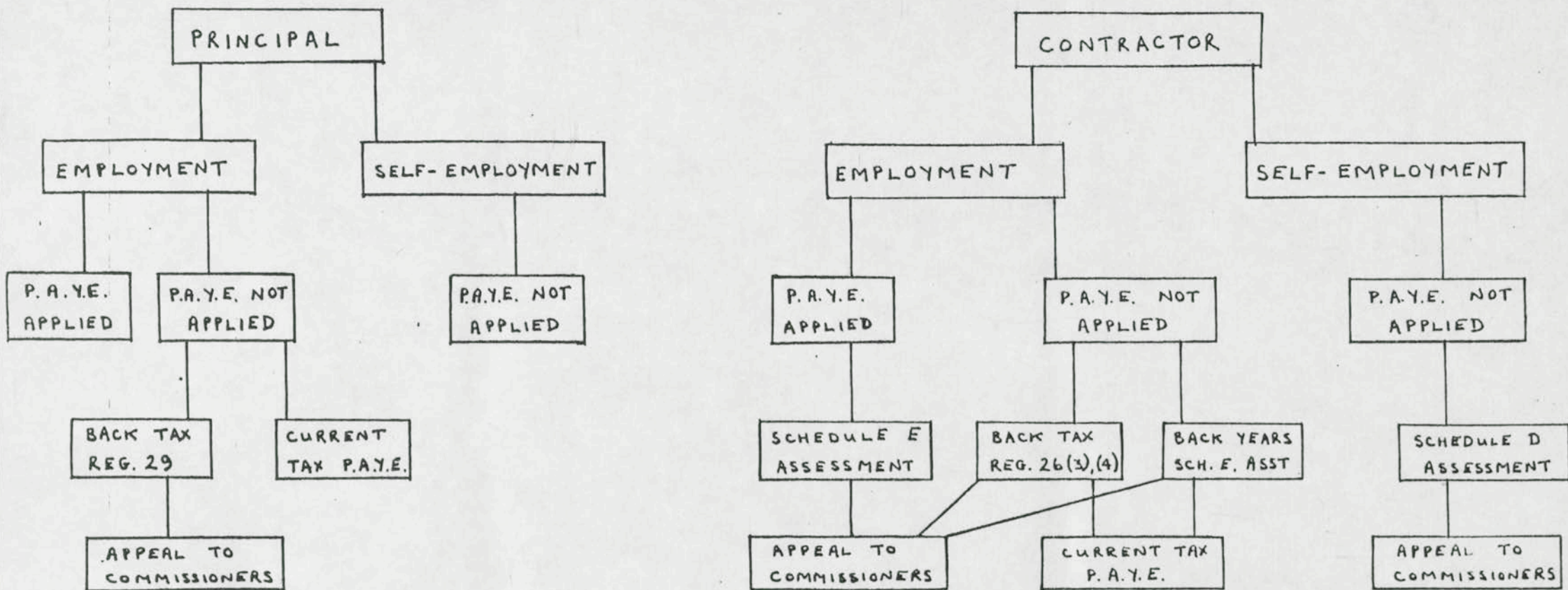
- i. I do not know if I am an employee of ABC.
Please give a ruling.

or

- ii. I believe I am not an employee of ABC.
Please tell him that he should not apply
PAYE.

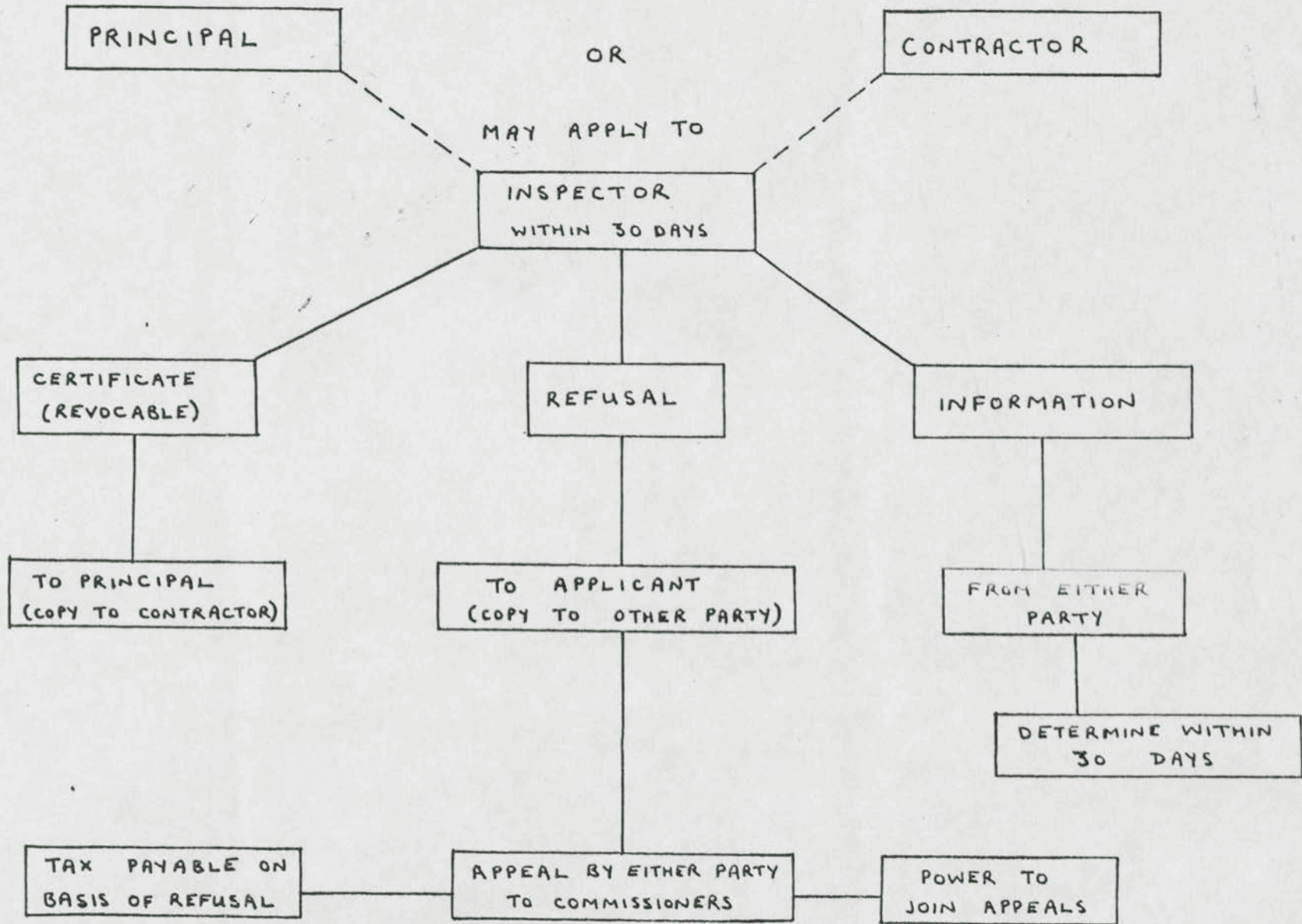
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STATUS QUO



EMPLOYMENT / SELF-EMPLOYMENT

PROPOSED MECHANISM FOR DETERMINATIONS



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Pt 3

8 MAR 1963



5 April 1983

Self-Employment

The Prime Minister has noted the interim report on the question of taxation of the self-employed which is contained in the minute of 30 March by the Chancellor of the Exchequer. Mrs Thatcher has made no comment on the contents of the minute.

AJC

John Kerr, Esq.,
H.M. Treasury.

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