



CCNO

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

AT O/V

weekend box?

SELF-EMPLOYMENT

attached at Ray

On 30 March last year Geoffrey Howe sent you an interim report on work on identifying ways in which people can be encouraged to enter self-employment and can gain a clearer understanding of what it means to be in business on one's own account. I have been looking further into this question, and after considering the various proposals outlined in Geoffrey's minute, I have concluded that there is no useful change we can make in the law in this area. I do think, however, that there is considerable scope for improving the public's awareness of what is meant by being self-employed and that this is where our efforts should be concentrated.

2. One of the things that John Moore and before him Nick Ridley have looked at closely is the scope for a statutory definition of self-employment. Our conclusion is that this is not the answer.

3. There are a number of reasons for this. First, the need for continuity and certainty. Employment status is a matter of general law and to introduce a new and separate test for tax purposes would be to jettison existing case law in these matters and to introduce doubt and uncertainty which could only be solved by fresh litigation. It would also make little sense for people to be treated, as could become the case, as self-employed for tax purposes but as employees for other purposes - National Insurance, redundancy, employment protection and so on.

4. Second, uncertainty over a person's employment status arises principally where part-time or casual engagements are concerned. Earnings from these sources are unlikely to be sufficient to form the basis of genuine small businesses or self-employment and in any case are frequently not declared to the Inland Revenue. In these cases, not only is Schedule E the right schedule in law, but also PAYE ensures that the tax is collected in a cost-effective way.



5. Third, the general law already provides, in essence, that a self-employed person is one who is "in business on his own account". It is difficult to see how this description of what self-employment is all about could be bettered. The law already treats those people we want to encourage - those who go it alone and set up independent enterprises - as self-employed. Introducing a different tax regime for some people who are in reality employees would not change the way they do their work or lead to the growth of independence and enterprise. It would, however, result in a loss of tax revenue.

ie in advance
6. Paragraph 23 of Geoffrey Howe's memorandum described a clearance procedure for establishing employment status. This is superficially attractive but on further examination I believe its disadvantages outweigh its attractions. A clearance procedure can only confirm a person's employment status, it cannot change it. There is no evidence that there are people genuinely "in business on their own account" paying tax as employees, and introducing such a procedure could only raise false expectations among those employees who would prefer to be treated as self-employed. In addition, such a scheme would entail very heavy manpower costs: it is estimated that to deal with 100,000 applications a year the Inland Revenue would need perhaps 150 extra highly trained staff.

7. I believe, therefore, that the best answer lies in two complementing initiatives. First, there is no doubt that many people would welcome a short, clearly written statement setting out in ordinary language what is meant by being self-employed. I have asked the Revenue to prepare a leaflet which does this, explaining the tests that are applied in determining whether a person is self-employed or an employee. A copy of the proposed draft is attached to this minute (Appendix I). A further aim of the leaflet is to give the general public a clear picture of the rights and obligations not only of the self-employed but also of employees. If you are content with this approach, I shall ask the Inland Revenue to go ahead with publication of the leaflet.

8. Second, we need to get across more effectively to our supporters in the country and others the many measures we have introduced to encourage the setting up and expansion of new businesses and which have been reflected in the growth of over 20 per cent in the number of self-employed since we first took



office in 1979. Of course, as we discussed at your meeting on 24 July, many of the difficulties which small businesses complain of have nothing to do with tax or questions of employment status and lie in the field of employment legislation, trading laws, planning permission and so on. But on the tax side the process of getting the message across has already begun. John Moore's speech to the Institute of Directors on 30 July, of which I attach a copy, on the steps we have taken to encourage self-employment was a beginning, and I intend that this should be followed up by further speeches as opportunity permits.

9. We also need to counter the unfounded impression that the Inland Revenue are somehow conducting a "drive" against the self-employed. As recent Parliamentary Answers (Appendix 2) have made clear, those "reclassified" in the past three or four years have not been small businesses on any sensible interpretation of those words. Indeed, fewer than 70 individuals in the last year have written to Ministers, including yourself, because they disagreed with the Revenue over their tax status. There would still be advantage, though, in the Revenue and indeed Treasury ministers looking for further suitable occasions to set the record straight.

10. I am copying this minute and attachments to Tom King and David Young.

A handwritten signature in black ink, appearing to be "N.L." with a flourish.

(N.L.)

28 September 1984

Tax : Employed or Self-Employed?

There are about two and a quarter million self-employed people in this country working either alone or in partnership with others. This is nearly half a million more than five years ago. By comparison, there are over twenty million people drawing wages and salaries in paid employment.

Employed, or self-employed?

Do you know whether you are employed, or self-employed? 'Self-employed' is not defined by law, nor is it merely a matter of you or your employer calling your job 'employment' or 'self-employment'. It is something to be decided in a commonsense way on the facts of your case, looking at what you actually do, and the way you do it.

This leaflet tells you

- ° how to decide, if you are not sure, whether you are employed or self-employed
- ° the main ways in which being self-employed, as opposed to being employed, affects your tax position.

If you are in doubt or have any questions after reading this leaflet, please get in touch with your local tax office and they will be pleased to help or advise you. You will find the address in the phone book under 'Inland Revenue'.

If you are an office holder, such as a company director or the secretary of a club, you will be taxed as an employee anyway and need read no further.

How do I decide whether I'm employed or self-employed?

You are self-employed if you are in business on your own account. In most cases this will be obvious: for example if you are working for a company on a production line in its factory, you are employed. You are self-employed if you are in business on your own account - say, for example, running your own grocery shop. However real life is not always tidy, and sometimes people are not sure where the dividing line comes.

The following guidelines have been laid down by the Courts over the years. They should help you decide. You probably won't find any one of them enough in itself. You will need to look at your job as a whole - all the conditions you work under - in the light of all the guidelines.

The same guidelines generally apply for tax, national insurance, employment protection purposes, and so on, but if you are in doubt about your National Insurance position, you should consult your local DHSS office.

If you can answer 'yes' to the following questions, you are probably an employee:

- Do you have to do the work that you have agreed to undertake yourself (that is, you are not allowed to send a substitute or hire other people to do it)?
- Can someone tell you what to do, and when and how to do it?
- Does someone provide you with holiday time, sick pay or a pension? (Though a lot of employees don't get any of these.)
- Are you paid so much an hour, a week, or a month? Can you get overtime pay? (Though many employees are paid by commission or on a piece-work basis.)
- Are you expected to work set hours, or a given number of hours a week or month?
- Do you work wholly or mainly for one business? (But remember that many employees work for more than one employer.)
- Are you expected to work at the premises of the person you are working for, or at a place or places they decide? (But remember that a self-employed person, such as a plumber, may by the nature of the job have to work at the premises of the person who engages him.)

If you can answer 'yes' to the following questions, it will usually mean that you are self-employed:

- Are you ultimately responsible for how the business is run? Do you risk your own capital in the business? Are you responsible for bearing losses as well as taking profits?
- Do you yourself control what you do, how you do it, and when and where you do it? (Though many employees have considerable independence.)
- Do you provide the major items of equipment you need to do your job (not just the small tools which many employees provide for themselves)?
- Are you free to hire other people, on terms of your own choice, to do the work that you have agreed to undertake? (But remember that an employee may also be authorised to delegate work or to engage others on behalf of his employer.)
- Do you have to correct unsatisfactory work in your own time and at your own expense?

What happens about my tax if I'm self-employed?

If you are self-employed, you are responsible for your own tax. This means:

- telling your local tax office (if you haven't already done so) that you are in business
- making a return of your income to the tax office each year so that they can assess the tax due on it (the tax office will send you a standard form for doing this)
- paying the tax: for the first tax year in which you are in business you don't have to pay the tax until after the end of that year, but after that you normally pay it in two instalments, on 1 January and 1 July of each year.

Remember that being self-employed affects not just your tax, but also your national insurance contributions. For more information about this, see leaflet NI41, which you can get from any DHSS office. It also affects:

- your entitlement to social security benefits, such as unemployment benefits
- other rights and duties, for example under the Employment Protection Acts
- your liabilities to the public for the work you do.

You can find more information about how your tax works if you are self-employed in the booklet IR28 'Starting in Business', which you can get free from any tax office. It also explains the effect of having partners in your business.

What happens about my tax if I am an employee?

If you are an employee, your employer will normally be responsible for deducting your tax from your wages or salary under PAYE, and paying it over to the Inland Revenue.

To sum up....

This leaflet has tried to help you decide whether you are employed or self-employed. Remember that:

- if you are employed, it ^{is} your employer's responsibility to apply PAYE and deduct tax from your pay
- if you are self-employed, it is your responsibility to tell your local tax office when you start up in business, and then to carry out your other tax obligations.

If you are really not sure whether you are employed or self-employed, please get in touch with your tax office for advice. The Inspector of Taxes can then give his opinion. If you disagree with him, you can appeal against any tax assessment he makes. If you still cannot agree after discussing it with him, you can ask for your case to be heard by an independent panel called the Appeal Commissioners.

The tax office will also be pleased to advise you if you are paying someone to do work for you and you are not sure whether you are their employer and so responsible for operating PAYE on their wages. Leaflet IR53 'Thinking of taking someone on?' tells you more about this.

These notes are for guidance only and do not affect your right of appeal about your own tax.

24/11/83

16/1/84

Association of Cinematograph Television and Allied
Technicians X

Mr. Neil Hamilton asked the Chancellor of the Exchequer what is the estimated number of taxpayers who have been reclassified by the Inland Revenue as liable to income tax on schedule E as opposed to cases I, II and VI of schedule D, respectively:

(2) pursuant to his reply to the hon. Member for Tatton, *Official Report*, 13 July, c. 384, how many taxpayers in each category mentioned were reclassified by the Inland Revenue as being liable to income tax on schedule E.

Mr. Moore: I regret that detailed figures are not available, but it is estimated that in recent years the numbers of taxpayers in the various categories mentioned in that reply are as follows:

Full-time Work

Certain workers in the film, television and radio industries—7,000.

Part-time or Occasional Work

Part-time club musicians—300;

Certain, mainly casual, journalists—700;

Occasional school etc examiners and markers—100,000.

As explained in that reply, the Revenue has concluded, following a review of its tax treatment, that these earnings are properly assessable under schedule E. In many of these cases the earnings in question were not previously declared for tax under any schedule E.

24/2/84

Mr. Neil Hamilton asked the Chancellor of the Exchequer how many taxpayers have been reclassified, since categories of earners were defined in the Social Security Act 1975, for national insurance purposes, from self-employment status to employment status.

Mr. Moore: I regret that the detailed information requested is not available. Information about certain taxpayers who have had the tax treatment of some of their earnings or their employment status for tax purposes changed or determined for the first time were given in my written answer to my hon. Friend's earlier question on this subject on 16 January at c. 15.

28/2/84

Mr. Neil Hamilton asked the Chancellor of the Exchequer if he will publish in the *Official Report* the general criteria used by tax inspectors for distinguishing between employment and self-employment for income tax purposes.

Mr. Moore: As I stated in my written answer to an earlier question by my hon. Friend—[Vol. 50, c. 25]—the criteria used by Inspectors of Taxes and taxpayers' professional advisers to determine employment status for tax, as for other purposes, have been independently established by the courts as a matter of general law. The criteria include such questions as who controls the manner in which the duties are performed, who bears the financial risk, who supplies equipment, and how the payment for services is made. None of them is conclusive in itself, and the importance of any single factor may vary from case to case. The Inland Revenue is preparing a guidance note for publication which will explain the relevant criteria and help taxpayers to understand the issues involved.

42. Mr. Brinton asked the Chancellor of the Exchequer whether he has come to a satisfactory arrangement with the Association of Cinematograph Television and Allied Technicians concerning the proposals he made to transfer many members of this trade union to the schedule E category of taxation.

Mr. Ian Stewart: A number of meetings have been held with the Association of Cinematograph Television and Allied Technicians and other representative bodies in the industry. Agreement on the taxation treatment of freelance workers in a number of grades has been reached and a further meeting is planned. Anyone who does not

agree with his classification for taxation purposes may, of course, ask to have the matter heard on appeal before the general commissioners.

24/10/83

Insurance Salesmen (Taxation)

Mr. Michael Forsyth asked the Chancellor of the Exchequer further to his answer of 29 July, *Official Report*, c. 733, if he will estimate how many insurance company employees involved in selling life insurance are treated as self-employed for tax purposes.

Mr. John Moore: I regret that information is not available centrally on the numbers of life insurance salesmen who are treated as self-employed for tax purposes.

28/7/83

Insurance Salesmen (Taxation)

Mr. Michael Forsyth asked the Chancellor of the Exchequer if he has any plans to change the rules which allow insurance company employees involved in selling life insurance to be treated as self-employed for tax purposes.

Mr. Ridley [pursuant to his reply, 28 July 1983]: It is the law which lays down the rules for determining self-employment. The tax status of life insurance salesmen as employees or self-employed depends on the particular circumstances of their engagement. Anyone who believes he is wrongly assessed may appeal to the commissioners.

Tax Status (Contract Workers) 5/12/83

Mr. Neil Hamilton asked the Chancellor of the Exchequer what income tax status the Inland Revenue applies to taxpayers whose sole source of income arises from their being (a) contract crop pickers and (b) contract dairy herdsmen.

Mr. Moore: An individual's employment status for taxation purposes depends on whether the terms and conditions of his engagement amount to a contract of service or a contract for services. The forms of engagement of most casual crop pickers are such that they will generally be employees assessable under schedule E; those of dairy herdsmen vary in practice and the employment status of any individual herdsman will depend on the particular facts.

CONFIDENTIAL



10 DOWNING STREET

6
cc. P. Wavry

From the Private Secretary

8 October 1984

Self-Employment

The Prime Minister has seen and noted the Chancellor's minute of 28 September and the papers attached to it.

Andrew Turnbull

David Peretz Esq
HM Treasury.

CONFIDENTIAL

CST.

②

PRIME MINISTER

ms.

The Chancellor has looked further at the issue of self-employment. He concludes against a new statutory definition or an advance clearance procedure.

He recommends an effort:

- (i) to improve public awareness of what is meant by being self-employed
- (ii) to publicise Government's record on promoting small business.

The Policy Unit note attached urges "extending the right of all people to become self-employed". But there is no right to become self-employed - one's employment status is a matter of fact and law.

Content with Chancellor's proposals?

AT

5 October 1984

MR TURNBULL

4 October 1984

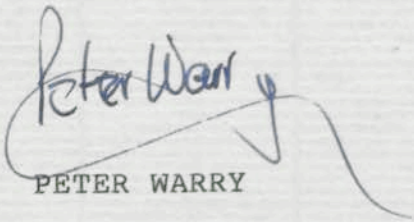
SELF EMPLOYMENT

The main deterrent to job creation by small employers is the burden of employment law and taxation duties that they immediately incur. 'Passport for Jobs' would exempt employers from these requirements for young people earning less than a set figure. Tom King is still working on the problem.

An alternative approach is to extend the right of all people to become self-employed. This would immediately make them more 'employable' as the burden of operating their PAYE, national insurance and statutory sick pay would not fall on the 'employer' nor would he be so constrained by wages councils, employment law and Health and Safety at Work.

Of course the Chancellor would suffer as part of the burden of collecting the income tax and national insurance would be transferred from the small businessman to the Inland Revenue. If we moved to a system of standard business allowances for the self-employed this work could be simplified as well as providing further incentive to become self employed.

We believe a drive towards self-employment is not only consistent with Conservative goals but is one of the few ways we can make a long lasting positive impact upon job creation and enterprise. You should not allow the Chancellor to rule out a change in the law in order to keep small businessmen doing the Inland Revenue's job.


PETER WARRY



H. M. TREASURY

Parliament Street, London SW1P 3AG, Press Office: 01-233 3415
Telex: 262405

PLEASE NOTE EMBARGO

NOT FOR PUBLICATION, BROADCAST
OR USE ON CLUB TAPES BEFORE
19.00 HRS ON MONDAY 30 JULY

30 July 1984

TAX AND THE SELF EMPLOYED

Attached is the text of a speech to be delivered tonight by the Financial Secretary to the Treasury, Mr John Moore MP, to the Institute of Directors' Tax Committee, in London.

PRESS OFFICE
H M TREASURY
PARLIAMENT STREET
LONDON SW1P 3AG
01 233 3415

133/84

TAX AND THE SELF-EMPLOYED

One of the most heartening developments in the economy during the past few years has been the surge in the numbers of self-employed which now amounts to over 2½m. For some years up to 1979 there had been little change in the numbers, but since then they have increased by about 400,000.

I very much welcome this big increase in the number of people working for themselves. The Government is firmly committed to the expansion of self-employment. We welcome the flexibility and efficiency which the self-employed sector shows. Nothing concentrates the mind like being one's own master, and nothing gives one a greater sense of responsibility than being one's own employer. We believe in ownership and we strongly believe in being responsible for one's own future. Self-employment is the seed bed from which thousands of successful, job-creating small businesses have grown. It is also the route back to work for many who have become unemployed.

This belief in the virtues of self-employment is reflected in the many measures we have taken which help the worker standing on his own and benefit small business in general. Since 1979 we have cut the basic rate of income tax by 3p in the pound and raised tax thresholds by 16% in real terms taking nearly 1m people out of tax altogether. We have cut the top rate of income tax on earned income from 83% to 60% and on investment income from a ridiculous 98% to 60%. The threshold for Capital Transfer Tax has been more than doubled since 1979, the upper bands substantially lengthened, the three top rates abolished and the lifetime charge reduced to half the rate on death throughout the scale. The Capital Gains Tax threshold has been steeply increased and paper gains resulting

solely from inflation removed from tax since 6 April 1982. In the last Budget the Investment Income Surcharge was abolished making it that much more attractive for friends or relatives to supply the self-employed businessman with capital. And the Enterprise Allowance, which provides the unemployed person who chooses to strike out on his own £40 a week for a year, has been instrumental in turning unemployment into self-employment.

Smaller firms in general have benefited a great deal from the very generous tax relief available under the Business Expansion Scheme to investors putting up money for small firms. The VAT registration threshold has been nearly doubled. And for small companies the rate of Corporation Tax has tumbled from 42% to 30%.

All these measures show this Government's commitment to fostering self-employment and the small business sector. I therefore find it puzzling and rather saddening that the Government is sometimes accused of allowing the tax system to be administered in a way which is unhelpful. We have even been accused of conducting a vendetta against the self-employed. Let me try and explain the rules for taxing self-employment. And let me also offer some reassurance about how those rules are applied.

Starting at the beginning, there has to be some difference in the way the tax liabilities of the self-employed are calculated compared with those of employees. Income earned from employment is fairly straightforward. It's your pay, plus any non-cash benefits you may enjoy. The expenses of your employment - the cost of equipment and of other facilities - are generally covered by your employer. Income from self-employment is more difficult to establish. In principle it is the receipts of the business less the cost and expenses of running it, but this can seldom be calculated on a day by day

basis. What expenses are necessary to carry on and expand the business must be a matter primarily for the self-employed person; the tax inspector has only to satisfy himself that they are laid out wholly and exclusively for the purpose of the business.

In our system these differences are recognised in the distinction between Schedule D of Income Tax, which applies to self-employment, and Schedule E, which applied to employees. There is nothing magical about our schedular system as such. Some other countries get along perfectly well without it. But there will always be a difference between the way the greengrocer's taxable income is calculated and the way the taxable income of the greengrocer's assistants is worked out. The borderline between Schedule D and Schedule E is one way of recognising this difference.

This brings me to an important point. The tax system seeks to reflect the world as it is. If someone is self-employed then he should pay tax under Schedule D. But applying Schedule D will not have the converse effect of making him self-employed. It is not the tax system which converts an employee into an entrepreneur. It is the man himself. The tax system merely follows after him. Some people seem to think that if only we switched the whole country from Schedule E to Schedule D we should witness an astonishing upsurge of hard work and business flair. I am afraid the answer to reviving our economy is not as easy as that.

Let me also make a distinction between the significance of employee or self-employed status for taxation purposes and its significance in other ways. Employment status is a matter of general law and affects a whole range of rights and obligations under different legislation. Employees are, of course, covered by the employment protection legislation. Self employed persons are not. Employees enjoy sick pay, can claim compensation

for unfair dismissal, may have a company pensions scheme. The self-employed have none of these things. These and other benefits may well have much more important economic effects than status for tax purposes.

This is not a question I want to examine in any depth today. Suffice it to say that whether or not a person is for instance covered by the employee protection legislation does not depend primarily on whether they are taxed under Schedule D or Schedule E. It depends on whether the courts judge them to be employees or self-employed.

The question of whether someone is an employee or is self-employed is not a matter of choice but a matter of fact. That is true both for Government departments administering the law and for the individual. Ultimately it is not up to the Inland Revenue to decide whether someone is an employee or self-employed. It is up to the courts. Similarly the individual cannot choose as to whether in any particular circumstances he is an employee or is self-employed. He either is or he isn't.

It follows that there can be no campaign by the Inland Revenue to reclassify large sections of the workforce from Schedule D to Schedule E as some critics have alleged. The Revenue has the duty to administer the law as it stands, in accordance with the facts as they are - it has no discretion to run a campaign that is contrary to the law. Where new facts do come to light the Revenue must apply the law. Let me emphasise, however, that Ministers are alive to changes in the patterns of work, and are determined to see that the legislation reflects the Government's clear commitment to encourage self-employment and small business. Equally, it can happen that the facts point to the conclusion that someone who has previously been treated as an employee should in future be treated as a self-

employed sub-contractor. If the facts justify the change, the Revenue must apply the law there too. The facts determine the issue either way. Ministers keep closely in touch with the Revenue's administration of the system. I repeat therefore that there is no campaign - nor has there ever been in the course of this Government.

There are, of course, difficult areas of judgement near the borderline. There always are in real life. But by definition those taxpayers whose status as self-employed is most uncertain are likely to be least entrepreneurial. There is absolutely no doubt about the status of the genuine risk-takers - the self-employed businessman, the craftsman working on his own account. Where there is doubt there is usually less risk.

During the last few years there has been a total of 107,000 reclassifications of income from Schedule D to Schedule E. That sounds like a lot until you recognise that over 100,000 of these refer to the spare time earnings of workers the vast bulk of whose income was already charged to Schedule E but who had a few hundred pounds a year assessed to Schedule D, namely schoolteachers marking exam papers. Examination markers do valuable work but they are rarely in business on their own account. After a very careful review of the facts with the co-operation of both employers and the trade unions concerned, including the National Union of Teachers and the Association of University Teachers, it was decided that it would be more appropriate to assess fees for marking exam papers under Schedule E, PAYE has therefore been applied to these earnings since April last year. Similar considerations have applied to most of the other groups of people who have had some or all - but usually only a small part - of their earnings brought within PAYE where they properly belonged. In most cases they, or their union representatives, have accepted the

Revenue's decision as right in law. And if they did not of course it would always be open to them to challenge the Inspector's interpretation before the independent appeal Commissioners and ultimately before the courts.

Let me offer a brief outline of the law in this area. The words "employment" and "self-employment" are not defined in any Act of Parliament, but over the years the Courts have had to consider their meaning on a number of occasions. They have identified various factors that need to be weighed in comin to a conclusion in any individual case. Briefly the Courts' approach has been to look at commercial and industrial realities and at the terms and conditions under which people work. They have recognised that self-employed people generally bear the full consequence of their own actions and those of their employees. They reap the reward or stand the losses of their venture, while employees, however diligent or vital to the business, in general do not.

The Courts have held that the question to be answered in deciding whether someone is self-employed is, ultimately, "Is this person in business on his own account?" The detailed tests used by Inspectors of Taxes and accountants and other professional people in considering employment status all flow from this central question whether a person is in business on his own account. Does the principal have control over the way in which the worker performs his duties? Does the worker take a financial risk? Does he provide his own equipment or set his own hours and conditions of work? These tests give clear and straightforward enough answers in the majority of cases. After all, no-one would suggest that a shopkeeper owning and running his own shop was an employee or that a production line worker at, say, BL was self-employed. On the other hand, it is true that there can sometimes be difficulties

and uncertainties on the margins, particularly where short-term engagements are concerned.

Anyone who is at all unsure of his employment status for tax purposes or of the status of people carrying out work for him should, of course, ask his Inspector of Taxes for guidance. Inspectors are ready to help and advise and they will willingly give guidance if asked. But on the particular question of employment "status" something more than this is widely thought to be needed and I have therefore asked the Inland Revenue to prepare a leaflet setting out in simple and straightforward language the considerations that are applied in determining employment status for tax purposes. This will be available shortly. Such a leaflet will, I hope, help to make the subject more accessible to ordinary business people and employees and dispel many of the misunderstandings that have sometimes arisen in the past.

