

technical factsheet 132

Employment status

INTRODUCTION

With this Government's stance on tax avoidance, it is perhaps unsurprising that there appears to have been an increase in the number of status enquiries by HMRC recently. Employment status is an area in tax law that is not straightforward.

CHANGES TO THE CONSTRUCTION INDUSTRY SCHEME

The government's proposed changes to the Construction Industry Scheme (CIS) have again focused attention on the issue of employment status. There is arguably no other industry where this issue is as prominent as the construction industry.

In summary the changes to the CIS will be:

- the scrapping of cards, certificates and vouchers to record payments to subcontractors;
- the requirement for subcontractors to be registered with HMRC, or suffer a higher rate of deduction;
- monthly returns to be sent to HMRC by contractors showing payments to all subcontractors. Nil returns will be required if no payments are made in any month. The return will include a declaration that none of the subcontractors are employees.
- subcontractors to be given pay statements by contractors if deductions made.

HMRC stresses in its guidance to the changes that "as now, contractors must ensure the correct employment status is applied to their workers."

The changes are expected to come into force from April 2007. For more information see <http://www.hmrc.gov.uk/new-cis/index.htm>

It is important to determine now whether workers are employed or self-employed and it is the aim of this fact sheet to give some guidance on this issue.

EMPLOYED OR SELF EMPLOYED?

It is necessary to determine whether a person works under a *contract of service* (employment contract) or a *contract for service* (subcontractor). According to HMRC there is no statutory definition for either of these terms. Additionally, the contract could be verbal, rather than written, and implied rather than express. What the relevant parties call their relationship, or what they consider it to be, is not conclusive. It is the reality of the situation that matters.

Case law indicates that there is not one simple test to apply in determining a person's employment status. What is important is the picture painted by the overall results of the many tests applied.

TESTS/INDICATORS OF EMPLOYMENT STATUS

If the answer to all (or most) of the following questions is 'yes', then the worker is *probably* an employee. The individual can only be said to *probably* be an employee as other factors, such as decisions in case law also need to be taken into account:

- do they have to do the work themselves?
- can someone tell them at any time what to do, where to carry out the work or when and how to do it?
- do they usually work a set amount of hours?
- can someone move them from task to task?
- are they paid by the hour, week or month?
- can they receive overtime pay or bonus payments?

None of these tests provides a definite answer on its own. For example, an expert, such as a ships captain or brain surgeon, would answer 'no' to the second question, but could still be an employee. In *Bhadra v Ellam* (1988) it was held that a hospital consultant would generally not require supervision, direction or control, but the locum doctor was found to be employed because the case considered the element of control and its relationship with responsibility.

If the answer to all (or most) of the following questions is 'yes', then the worker is probably self employed:

- can they hire someone to do the work, or engage helpers at their own expense?
- do they risk their own money?
- do they provide the main items of equipment they need to do their job, not just the small tools that many employees provide for themselves?
- do they agree to do a job for a fixed price regardless of how long the job may take?
- can they decide what work to do, how and when to do the work and where to provide the services?
- do they regularly work for a number of different people?
- do they have to correct unsatisfactory work in their own time and at their own expense?

HMRC has produced an employment status factsheet CIS 349 which is available online. There is also a website with an online tool to help determine employment status, and this can be accessed at www.hmrc.gov.uk/employment-status.

CASE LAW

In the absence of a definitive statutory definition of employment as compared to self employment, it is necessary to look to case law to try to ascertain the legal position.

Ready Mixed Concrete Ltd v Minister of Pensions & NI (1968).

This case can perhaps be considered something of a landmark case in this area.

The company (RMC) made and sold ready mixed concrete. When the contract it had with an independent haulier to deliver the concrete to customers expired, it introduced a new scheme whereby deliveries were carried out by "owner-drivers", who worked under written contracts.

The owner-drivers purchased their own lorries by means of a hire purchase agreement with Readymix Finance Ltd. The mixing equipment on the lorry remained the property of the company. In 1965, the employment status of a driver, Mr Latimer, was considered by the Minister of Social Security.

Mr Latimer's contract included the following:

- he was entitled to appoint a competent and suitably qualified driver to operate the lorry in his place (though this was only with the consent of the company, and subject to the company's entitlement to require him to drive the lorry himself unless he had a valid reason not to)
- he was responsible for the wages or pay of any such substitute
- he had to wear a company uniform
- he had to carry out all reasonable orders from any competent servant of the company
- he had to maintain and run the lorry at his own expense
- there was a mutual intention that he was an independent contractor

Other important considerations were that:

- he did not work set hours or have a fixed meal break
- RMC did not specify what route to take, or tell him how to drive the lorry
- the owner-drivers all arranged their holiday dates to ensure that only one driver was ever away on holiday at any one time. They appointed a relief driver and all contributed equally to his wage
- during the busy period, RMC appointed a few additional drivers under contracts of service

The minister's opinion was that Mr Latimer was an employee under a contract of service. On appeal to the High Court, MacKenna J disagreed and held that he was running a business of his own. In summing up, MacKenna J said that Mr Latimer was a "small business man" and not a servant, concluding that the contract was one of carriage, not of service.

It is clear that on balance, if the Revenue's indicators are applied to Mr Latimer's circumstances, the overall picture is of self employment rather than employment. There are a few questions though that do not produce the correct answer. Mr Latimer could be moved from task to task as he had to carry out all reasonable orders from the company. This is an indicator of an employee. Additionally he did not work for a number of different people, which is an indicator that he was not self employed. However the decision reached by MacKenna J does appear on the whole to be correct and fair, as it looks at the picture painted by the overall results of the many tests.

O'Kelly v Trusthouse Forte plc (1983)

This is another interesting case. Trusthouse Forte (THF) kept a list of 100 casual catering staff known as 'regulars' who worked at the Grosvenor House Hotel in London. THF employed permanent staff, but engaged casuals to provide catering and other services as and when required in relation to their business of hiring out rooms for private functions. Weekly rosters were published.

Mr O'Kelly was a wine butler and he worked virtually every week for hours varying from as little as 3 some weeks to as many as 57 in other weeks.

Some of the factors that indicated that Mr O'Kelly was an employee were:

- no capital invested, and no opportunity to gain or lose
- THF exercised control
- he was part of the THF organisation when he was working
- his clothing and equipment were provided by THF
- he was paid weekly in arrears
- there was a disciplinary and grievance procedure in place
- there was holiday pay and incentive bonuses

Some of the factors that indicated he might not be an employee were:

- he was paid only for work performed, no regular wage or retainer
- there was no sick pay, he was not in the pension scheme
- there were no regular or assured hours
- the contract was terminable without notice by either party
- applicants could choose whether or not to accept work
- THF had no obligation to provide work
- there was a mutual intention for self employment
- it was the custom in the industry-casuals engaged under contracts for services.

The Industrial Tribunal found that the 'regulars' were working under contracts for service, in business on their own account because there was an absence of mutuality of obligation. The EAT disagreed on the basis that each individual contract was a separate contract of service and that the Industrial Tribunal had not considered this point. The Court of Appeal decided by a majority that the Industrial Tribunal had considered both general and separate engagement points, so the EAT should not interfere with the decision. The decision that the workers were self employed was therefore reinstated.

Sir John Donaldson M.R. said in his judgement that "the Industrial Tribunal's decision may have been surprising but it was certainly not perverse in the legal or any other sense."

If the Revenue's indicators are applied to the facts of the O'Kelly case, the Industrial Tribunal's decision is indeed surprising. The tests for determining whether a person is employed, when applied to Mr O'Kelly produce five 'yes' answers from six questions. The tests for determining whether a person is self employed, when applied to Mr O'Kelly produce seven 'no' answers and no 'yes' answers. Therefore, if using these indicators, looking at the overall picture would imply that Mr O'Kelly was an employee, which is exactly the opposite of the outcome at court.

The emphasis in the court case was mainly on mutuality of obligation, that is to say, that the most important factor as far as the tribunal was concerned was that THF had no obligation to offer work to Mr O'Kelly, and Mr O'Kelly had no obligation to accept any work that was offered.

In *Nethermere (St Neots) Ltd v Gardiner* (1984) Stephenson LJ accepted that the O'Kelly case was correct and identified the approach that the Tribunal must take in the following terms: "The court therefore has to.....decide whether the Industrial Tribunal misdirected itself in law or reached a decision which was unreasonable to the point of perversity."

Bunce v Postworth Limited trading as Skyblue (2005)

Another aspect of employment that has featured in several court cases in recent years is agency work. This case dealt with an employment agency. Mr Bunce made a claim for unfair dismissal against Postworth Limited, trading as Skyblue, an employment agency and G.T. Railway Maintenance Limited, trading as Carillion Rail, a company whose business is railway maintenance and civil engineering.

Mr Bunce, a welder, entered into an agreement with Skyblue which resulted in him being sent to carry out welding work for Carillion Rail and other companies. Mr Bunce signed a written agreement with Skyblue which stated, "For the avoidance of doubt these terms and conditions shall not give rise to a contract of employment." His engagement was ended by Skyblue after 52 weeks, during which time he worked on 142 assignments, all but 39 of them for Carillion Rail. He worked for all or part of each of the 52 weeks. The employment tribunal ruled that he was not an employee of either Skyblue or Carillion Rail.

No appeal was lodged against the decision that he was not an employee of Carillion Rail. An appeal to the EAT was solely concerned with whether he had been an employee of Skyblue. The EAT upheld the decision on two grounds: that there was an absence of mutuality of obligation between Mr Bunce and Skyblue and secondly, that on the facts, in particular, the minimal control exercised by Skyblue, it was correct to conclude that there was no contract of service with Skyblue.

In the Court of Appeal the written agreement was discussed. Included in the agreement was an explanation that no liability would arise if Skyblue failed to provide work for Mr Bunce. Mr Bunce also agreed that there would be times when no work would be available and that he was not obliged to accept any work offered to him by Skyblue.

Mr Bunce was paid at an agreed hourly rate for the number of hours he worked, which were recorded on a timesheet and signed on behalf of Carillion Rail. Tax and national insurance was deducted for his pay and he was entitled also to paid annual leave, though not to sick pay. He was provided with training and tools by Skyblue.

The signed agreement also dealt with Mr Bunce's obligations for every assignment, stating that he would: "co-operate with the client's staff and accept directions, supervision and instruction of any person in the client's organisation to whom he is responsible and conform to the client's rules and regulations and normal hours of work and practice."

Mr Bunce was informed verbally by Skyblue that his services were no longer required after there were complaints by Carillion Rail about alleged deficiencies in his work.

Mr Bunce sought to rely on the signed agreement being proof that there was an element of control by Skyblue. Lord Justice Keene stated that: "The law has always been concerned with who *in reality* has the power to control what the worker does and how he does it. In the present case, during the periods when the appellant was working on an assignment, it was the client, the end-user, who had the power to direct and control what he did and how he did it. That is not in dispute. Skyblue could not exercise such control over the appellant."

If the Revenue's indicators are applied to Mr Bunce's circumstances, the overall picture painted would appear to be one of employment. However, control was the key factor in this case. It was true that someone could tell Mr Bunce what to do, where to carry out the work or when and how to do it, but that 'someone' was not from Skyblue, but rather from the client (Carillion Rail), so the employment relationship could not exist between Mr Bunce and Skyblue.

Demibourne Ltd v HMRC (2005)

This more recent case relates to the situation where a person changes their status from employed to self-employed, when, in essence, their role remains much the same.

Demibourne Ltd took over a hotel business, retaining the employees of the hotel. Mr Bone, who was employed as a maintenance man retired when he reached the age of 65, but expressed a wish to continue working at the hotel. The company agreed, but no written contract was drawn up.

From the date that this was agreed, no PAYE was operated. Mr Bone was considered to be self employed, and accounted for his own tax. There was no change to the nature of his work. He used all his own tools-both prior to and after his retirement. Before he was 65 he had four weeks' paid holiday each year, but afterwards he did not receive any holiday pay, or pay for bank holidays.

Before his retirement Mr Bone was paid a weekly wage of £255 per week. His accounting records showed that he continued to receive that amount afterwards too. Some weeks he was paid £306 for working six days, and sometimes £204 for working four days, which equates to the same daily rate as £255 for a five-day week.

The Special Commissioner, John Clark concluded: "Taking all the factors together, I do not consider that the changes made.....were sufficient to replace the relationship of employer and employee with one between client and independent contractor. Although the parties' intention may be a significant factor, it cannot on its own determine the nature of the relationship. Whatever the parties may have believed that they were doing in arriving at the agreement concerning Mr Bone's engagement, the overall effect of the contractual terms, taken together with the course of conduct as between the parties, was to continue a relationship of master and servant."

This case again deals with the issue of control. It is not uncommon for a worker to cease employment and commence 'self-employment' for the same employer and under similar terms. In professional firms, there may often be consultancy arrangements along these lines. In addition to considering the HMRC indicators, it is also essential to establish whether there has been a discernible change in the arrangements after the self-employment commences.

RECOMMENDATIONS

Employers/contractors need to make sure that they are prepared for any status enquiries, and that they have established the correct status of any workers. As a guide, the HMRC indicators should be used, but the overall conduct of the worker also should be looked at. It may be useful to have a positive statement from the worker stating what he perceives to be his employment status.

CONCLUSION

The line between being employed or self employed continues to be very blurred. The Revenue's indicators provide a useful starting point in trying to establish the correct position. However, from the case law in this area, it is clear that the indicators can only ever be a rough guide, and it is also very important to consider mutuality of obligation and the element of control.

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