



The voice of freelancing

Submission to the All-Party Parliamentary Group for the Freelance Sector

The Value to the UK economy of the use of the Freelance Sector

Executive Summary

A freelancer can provisionally be defined as a worker who:

- a) supplies their services on a commercial basis
- b) supplies their services to a range or succession of clients
- c) supplies services EITHER
 - i. which the general consumer would not typically seek to acquire, OR
 - ii. which are provided to consumers in a project-based manner, entailing more work than one or two visits, but not entailing an open-ended arrangement to perform the same or similar tasks repeatedly
- d) takes responsibility for securing work for themselves.

Further research work is needed, either to develop a more robust definition, or confirm this one.

There are approximately 1 million freelancers in the UK, contributing up to £100billion to the UK's GDP annually. Their added value to their clients cannot presently be calculated. It seems likely that several million people in the UK have worked freelance at some point in their careers.

Freelance work brings benefits for both the client and the freelancer: the client gains resources on a flexible basis, while the freelancer is able to advance their career in their chosen specialism and could gain a more flexible lifestyle.

The Government has placed numerous obstacles in the way of freelancers, most notably via the tax system. Some freelancers perceive this as a deliberate and sustained attack on freelancing.

Without freelancers, the UK's economy would slow, as costs would increase for the businesses that use freelance labour.



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Introduction

PCG is pleased to be responding to this inquiry: freelancing is widely neglected and misunderstood within the UK policy discourse, and we believe that the creation of the All-Party Group will be an important step in rectifying this.

Before responding to the main questions posed in the call for evidence, we wish to set out some thoughts on the definition of “freelancer”. Terminology in this area of policy and the various marketplaces for freelance labour is not consistently used: numerous terms are deployed in different contexts to refer to essentially the same types of worker, for instance “freelancer”, “contractor” or “consultant”. For ease, “freelancer” is used here throughout.

To confuse things further, there is no definitive quantitative study of the number of freelancers in the UK, what they do and what sectors they do it in. PCG is working to develop research into this question, and while we hope to see the first results from this work in the second half of 2008, it will not be completed in time to inform the Group’s report.

That said, some preliminary definitions and guesses at numbers can usefully be hazarded.

Definition

When seeking to define workers, it is tempting to look at the characteristics of the individual first and foremost; this can often produce confusing results. It is more helpful to look first of all at the relationships different workers have with their clients or employers. This instantly gives us the single most important criterion pertaining to freelance workers: they provide their services on a commercial basis.

It is vital to recognise that freelancers provide their services to a range or succession of clients on a commercial basis: they are not employed, and do not (or at least should not) refer to their “employers” - they have clients.

Employment status is not defined in any legislation - a difficulty for freelancers, to which this response will return - but its legal characteristics can be identified in case law. Employment is characterised by three main features:

- 1) the worker is obliged to enter into the personal service of their employer (ie they must do the work themselves, and may not send anyone else to do it);
- 2) the worker is under the direction and control of their employer (ie the employer dictates the time, place and other conditions such as dress - direction and control does not extend to telling a specialist such as, say, a brain surgeon how to execute their specialism);
- 3) and there is a mutuality of obligation between the employee and the employer (ie the employee has to keep turning up, and the employer has to keep paying them).

If one or more of these conditions is not met, the relationship is not one of employment, but one of self-employment.

In legal terms, an employment contract is referred to as a “contract of service” on the basis that the employee enters into the service of the employer (archaically referred to as a “master and servant” relationship). A commercial contract is referred to as a “contract for services” on the basis that the worker provides services to the client, but is not in their service. Freelancers use contracts for services.

It is not straightforwardly the case that freelancers are technically self-employed, however. Many are self-employed sole traders, but others own limited companies: they might be officers of their companies, or they might have a formal employment contract with the company - in some official figures, such as freelancers are counted as employees, rather than self-employed, even if they are not formally employed by their companies.



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Other freelancers operate via “umbrella companies”: these are companies that provide a corporate structure for the freelancer and remunerate the freelancer via the PAYE system, having received payment from the freelancer’s client. The technicalities of the way each umbrella company works can vary, but very often the freelancer will be, in a technical sense, the employee of the umbrella.

So, although all freelancers have self-employment relationships with their clients, not all are formally self-employed in the strictest sense - we can say no more than that all freelancers work in self-employment relationships. But if all freelancers work in a self-employed mode, does that mean that all self-employed people are freelancers? If not, what is the difference?

The boundary between “freelance” and “self-employed” in a more general sense is a contentious subject within PCG. PCG’s official view is that self-employed handyman, window-cleaners, gardeners and stall-holders, for instance, are not “freelance”; but isolating why they are not is difficult. Some PCG members firmly believe that construction labourers and plumbers should be regarded as “freelance” every bit as much as an IT contractor should - but others dissent from this view strongly.

It may be desirable to differentiate between freelancers and other self-employed people using criteria pertaining to the nature of their trade or profession: below a certain skill level - NVQ Level 4, say - it may not make sense to regard a worker as freelance. Alternatively, it could be stipulated that the freelancer necessarily carries out white-collar work, or “knowledge-based” work. But these approaches are all awkward: what is the difference between “knowledge” and “skill” - and would that make, say, a self-employed illustrator a freelancer or not?

An alternative approach is to return to the nature of the freelancer’s working relationships, rather than the actual work they perform or expertise they sell. It could be argued that a freelancer is distinguished by having business-to-business relationships, and also by not facing the consumer: the types of services offered by freelancers are perhaps those that the man on the street would not generally have cause to procure. By this definition, commercial divers in the oil and gas sector could clearly be “freelance”; window-cleaners going from door to door would not be.

This approach gives rise to awkward cases, however: what about a plumber who might take both domestic call-outs and business-to-business engagements on a commercial building site? What about an architect, who might be hired by a homeowner planning an extension, or a construction firm?

A further differentiating factor might be needed: the freelancer is the worker who is either engaged by a commercial client, or is engaged by a consumer on a project basis that is neither a one-off nor an ongoing routine appointment. So, a plumber who is called out to mend a radiator and then does not return in a planned way, or a cleaner who spends a morning cleaning a home on the same day each week would not be a freelancer; an interior designer commissioned to design and install a new kitchen - or any project that would require a substantial amount of work entailing more than simply one or two brief visits - could usefully be called freelance.

It can also be observed that freelancers must ultimately takes responsibility for finding their own work, and this forms the final part of the definition: they may use agencies to do this, but that is a commercial transaction like any other and it is still ultimately the freelancer’s responsibility to find the work. In some sectors the use of agencies is a standard practice, but this does not make the freelancer an “agency worker” in the generally-meant sense of the term: points (c)(ii) and (d) below differentiate freelancers from “temps”.

So, we have a working definition. A freelancer is a worker who:

- a) supplies their services on a commercial basis
- b) supplies their services to a range or succession of clients
- c) supplies services EITHER



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- i. which the general consumer would not typically seek to acquire, OR
 - ii. which are provided to consumers in a project-based manner, entailing more work than one or two visits, but not entailing an open-ended arrangement to perform the same or similar tasks repeatedly
- d) takes responsibility for securing work for themselves.

This is a provisional definition, and PCG hopes to be able to build on future research work in order to develop or even replace it over the coming months.

It must also be noted that it is perfectly legitimate for a freelancer to have only one client at a time: indeed, in many cases this may prove enough to be going on with. There is a lingering perception in many quarters that a freelancer with only one client is really that client's employee: in fact, if the relationship between the two parties is a commercial one, that is the end of the matter - it is not necessary to have more than one client at a time to be a "proper" freelancer.

Finally, it must be observed that freelancers are, by definition, in business: their relationships with their clients are commercial ones. This does not necessarily make them "entrepreneurs" - although that term is as awkward as any considered so far. Freelancers will often not seek to grow their business: their business model rests on supplying their expertise to a range or succession of clients. In some quarters it is held that the only "proper" business is a business that grows, in terms of taking on increasing numbers of employees - this notion is plainly bogus.

Numbers

There is no authoritative estimate of the number of freelancers in the UK. This is unsurprising, as there is no widely-agreed definition: even the definition presented above is highly provisional. However, PCG has used existing data sets in the past to produce crude estimates of the size and value of the marketplace.

PCG has extensive data regarding its own membership: this exhibits certain biases, and is not representative of the total freelance marketplace in the UK. This will be set out fully in the response to the first of the questions in the call for evidence. We are not able to quantify the freelancer marketplace beyond the PCG membership with much certainty.

Other data sets exist that contain, but do not isolate and quantify, the UK's freelancers. The Labour Force Survey compiles quarterly data for the Office of National Statistics, including data on employed and self-employed workers. In its most recent figures, it identified 3.9 million self-employed workers in the UK (2.95 million full-time, 0.95 million part-time) - 13% of the workforce.

The Department for Business, Enterprise and Regulatory Reform issues an annual set of SME Statistics. The most recent were released in August 2007 and give data for the start of 2006: they show that, of 4.5 million enterprises in the UK, 3.3 million have no employees.

The difference between a self-employed person (ONS data) and an enterprise with no employees (DBERR data) is not clear, but there is a consistent difference between the two sets of figures of several hundred thousands (ONS figures for the start of 2006 do not show self-employment at 3.3 million, but at 3.73 million). The DBERR figures for "size class zero" are, according to their methodological note, compiled using both LFS data and information from HM Revenue and Customs - the interaction of these two data sets presumably somehow accounts for the discrepancy.

The DBERR figures also show that of the 1,145,000 companies in the UK, 452,000 have no employees. PCG speculates that most of these will be freelancers: certainly the majority will be businesses that provide services, as those providing goods can seldom operate usefully with only one person, the main exception



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probably being the growing number of internet traders (though it is PCG's impression that these businesses are not generally incorporated).

Other surveys that might contain information on freelancers include the British Household Panel Survey (showing a 14% self-employment rate), the European Working Conditions Survey (also showing a 14% self-employment rate), the Family Resources Survey, the Global Entrepreneurship Monitor UK, the Recruitment and Employment Confederation Report on Jobs and the Millennium Cohort Study.

In 2006, PCG used LFS data to estimate the number of freelancers in the UK, using its sectoral breakdown as a proxy for a definition of "freelancer"; this produced an estimate of 990,000 freelancers in the UK across all sectors. Mapping the data from PCG's membership survey onto this figure gave an estimated contribution of freelancers to the UK economy of roughly £100 billion per annum (the actual figure that emerged was £98.8 billion).

This is an extremely crude "finger in the air" estimate, but it is supported to some extent by one item of supporting circumstantial evidence. The DBERR figures show the total turnover of all "size class zero" businesses as £208 billion. Thus, PCG's estimate shows the UK's freelancers as just under a third of the UK's self-employed / size class zero business population, but contributing just under half its turnover. Bearing in mind that the definition of "freelancer" reached above generally includes higher-skill, value-added services and excludes lower-skill, lower-value services, this seems plausible.

There is a case for saying the PCG figure may be a modest overestimate: size class zero businesses will include some purveyors of goods, whose turnover will necessarily be higher than that of many providers of services, even if their profits are not.

More research in this area is clearly needed, but in sum PCG currently feels reasonably confident in saying that the contribution to the UK economy by its freelance workforce is worth up to £100 billion annually.

This is, of course, not a calculation of the value that freelancers bring their clients: a client who pays a freelancer £10,000 for services that enhance the client's business by £100,000 (either in cost savings or by enhancing the client's value proposition) cannot be said to be contributing merely £10,000 to UK PLC; but to explore this question is a monstrously difficult task, and will require much more basic research into the freelance population to be conducted first.

It can also be observed that self-employment has been growing since 2001, and while self-employment cannot be directly equated with freelancing, it seems reasonable to infer that numbers of freelancers have been growing also. A report into this growth by the ONS in 2004 found that this growth could not be explained simply by changes to the tax system which, it suggested, made self-employment more attractive.

Characteristics

A further area for future research must be the characteristics of freelancers, both legally and personally.

To take one example of this, PCG is most familiar with freelancers who regard themselves as having "clients" and operate their businesses accordingly: they regard themselves as self-employed, and rely on themselves for sick pay, holiday pay and other entitlements that an employee would expect their employer to provide.

In the world of television, however, this may not be the case: the UK TV Freelancers website (www.uktvfreelancers.org.uk) prominently advises its readers to ensure that their "employer" is giving them their full holiday pay, which is, "a right you are clearly entitled to over and above your agreed freelance rate."



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PCG has very few members in this sector: it is dominated by BECTU, who we hope will also be responding to the call for evidence, as the mindset and legal structures of this kind of freelancing are clearly very different from those in the sectors with which PCG is more familiar.

**Why your organisation or organisations you represent need the services of freelancers?
What are the main benefits to you or those organisations?**

PCG wishes to address these questions together, and answer in two respects: firstly, considering why client organisations use freelancers, and secondly, why workers choose to work freelance.

1) Benefits to clients

Governments and courts have over time, quite rightly, awarded employees extensive rights. Businesses, however, have need from time to time for resources more flexible than can be acquired under terms of employment. There is a whole range of reasons for these needs: the skills needed might be specialised and not part of the client's normal requirements; there may be a project of limited or even uncertain duration; and so on.

In acquiring these skills on a non-permanent basis, the costs and responsibilities associated with employment are usually not appropriate. Freelancers are prepared to provide these resources as a service, taking on board the concomitant business risks. This has proved beneficial for many reasons.

- The clients gained because they had the flexibility they needed
- Freelancers gained because they had the advantages of being in business, such as career advancement and a more flexible lifestyle
- Employees gained because they could be given their rights without damaging employers' competitiveness
- Government gained because it could award employees such rights without wreaking economic damage
- The UK gained because these developments gave rise to a more flexible economy than would otherwise have existed.

The key point to emphasise is that freelance work exists because there is a commercial need for it. It is not a matter of individuals trying to escape from their tax obligations - if it were, clients would have no incentive to hire them. Nor is it a matter of larger companies trying to escape their obligations to employees - hiring freelance workers is a difficult business for many clients, and the legal difficulties involved would mean that it would not be a worthwhile exercise for most if there is no genuine reason to do it. The continued demand for freelance workers can only be driven by genuine market needs.

PCG can identify many sectors in which freelance working flourishes. First of all, it can be observed that any large corporation in the modern world tends to have a significant IT infrastructure: this can entail stock control for large retailers, the execution of transactions for banks or other financial institutions, or design and project-management systems for aerospace or other technical companies, for instance.

So it is unsurprising that among the functions carried out by PCG members, IT is the most prominent, at 46% - although this percentage has shrunk gradually as the membership has expanded over the last few years.

The following tables set this in context, showing both the functions performed by PCG members, and the sectors in which they work. They are drawn from PCG's annual membership survey of 2007, full details of which are available on the PCG website.



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Tables 1 and 2: functions performed by PCG members, and sectors in which PCG members operate

<i>Function</i>	<i>%</i>
IT	46.41
project management	14.76
engineering	13.69
other	8.03
technical design	5.89
management	5.05
financial	2.75
procurement	0.92
human resources	0.54
marketing	0.54
research	0.46
creative design	0.38
legal	0.31
broadcasting/technical	0.31

<i>Sector</i>	<i>%</i>
financial services	28.98
IT	27.75
public sector	13.61
telecommunications	12.84
oil and gas	12.16
energy and utilities	8.87
defence	7.11
aerospace	6.42
engineering	6.19
manufacturing	5.96
other	5.96
retail/wholesale/FMCG	5.58
pharmaceuticals	5.35
media	3.59

It can be seen that there are numerous sectors, and types of work, which are not strongly represented within PCG’s membership, but where freelance working can be safely presumed to flourish.

For instance, many aspects of television production rely on freelance labour: the nature of the work is that series are often produced for transmission across a limited time period, and then cease production until (maybe) resuming again the following year: this scenario makes freelance working patterns more or less inevitable, unless the programme is being made in-house by a large broadcaster.

The tradition of journalists and photographers working on a freelance basis in the UK is also well-known. As with television production and other arms of the media, the existence of well-established trades unions in these sectors probably explains the absence of these workers from PCG’s membership.

PCG’s data may also not reflect some of the finer distinctions made by others in the freelance marketplace. “Interim managers” often see themselves as distinct from “consultants” or “contractors”, and although the exact definition of this distinction is hard to pin down, it is strongly asserted by the Institute of Interim Management, the Interim Management Association and the numerous agencies that specialise in placing interims into clients. It may be that the “project managers” found among the PCG membership are essentially interims, but it is not clear that this correlation is either neat or total.

2) Benefits to freelancers

Freelancers operate by exposing themselves to commercial risk: if they succeed, the rewards are potentially greater than those of full-time employment; but if they fail, they will be left with no income and no safety net. So it is fair to say that freelancing is not for everyone.

Yet there are nearly four million self-employed people in the UK, and perhaps about a million of these are freelancers. Within this, PCG believes there must be quite a lot of churn: we know from our own membership that the most common reason for someone discontinuing their PCG membership is that they have returned to employment. Even though PCG has a retention rate of around 80%, this still means that there are substantial numbers of people moving from freelancing back into employment, even though self-employment is growing at present. This begs the question of how many people in the UK have worked freelance at some point in their careers: it must be numerous millions.

So, why do people work freelance? There are numerous reasons: some take conscious decisions to change the way they work, perhaps to fulfil an ambition to go into business, or to gain a more flexible lifestyle. Others may find that they have reached a point in their careers where the next logical step as an



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employee would be to take a management role, but they would rather continue to work in their specialism: to do this, they go freelance. Others still may find themselves redundant or otherwise left without options - the rise in self-employment in the mid-1990s suggests that this is common in times of recession, but perhaps not so widespread otherwise.

A survey commissioned by Giant PLC, an agency specialising in placing IT contractors, gives some insight into the motivations for going freelance.

Table 3: incentives to go freelance

Main incentive to go freelance	%
Lifestyle / flexible working benefits	37
Opportunity to charge more	22
Reduced tax bills	15

The results, published in November 2007, also showed that 61% of freelancers feel they thought the variety of work is better than when working as an employee, and 57% feel they have greater autonomy than employees (15% felt they had less).

A good case study of the modern freelancer might be the television news presenter Natasha Kaplinsky, who recently attracted some media coverage when it was announced that, as a freelancer, she would not be entitled to paid maternity leave from her client, Five. It seems fair to surmise, however, that Kaplinsky understood the nature of the engagement she was taking on when she joined Five: she has been quoted in the press as saying that the possibility that she might wish to start a family was discussed during contract negotiations. There can also be little doubt that her reported fee (referred to incorrectly as a “salary” in many media reports) is ample to support herself during pregnancy. By moving from client to client, Kaplinsky has forged a successful career path without any need for employment protections.

It can be observed that some companies seek to use freelancing as a way of introducing artificial restructurings: very often these will be implemented with the intention of reducing the business’s employee headcount, in order to make the business more appealing ahead of a takeover. In short, a selection of its employees will be made redundant, but return to their jobs - doing exactly the same work, in exactly the same way - immediately afterwards, this time on a “freelance basis”.

This trick, known as a “Friday to Monday” scenario, on the basis that the worker ceases to be an employee on the Friday but returns as a freelancer on the Monday, is not only disreputable, but legally dubious. The courts have made it clear that they are willing, if necessary, to look through “freelance” arrangements in order to find someone employed: if an employee goes “freelance” but carries on doing exactly the same work in exactly the same way, it is likely that they will, in fact, still be an employee. The Court of Appeal made exactly this finding in the *Cable and Wireless v Muscat* case in 2006.

This practice therefore risks backfiring massively on the employer, as well as leaving innocent workers believing that they no longer have employee protection. Some companies see it as a “benefit” of using freelance labour; PCG does not accept that this represents a legitimate role for freelance workers.

What, if any, are the obstacles placed by the Government on the use of freelancers?

The Government has placed numerous obstacles in the way of freelancers and their clients over the last ten or so years, to such an extent that many freelancers regard it as having perpetrated a calculated and merciless onslaught on freelancing as a way of working, with the perceived objective of destroying it utterly.

In 2007, PCG asked its members whether they felt freelancing was recognised as a valid business model by their clients, the agencies they sometimes use to find work, and the Government. For both clients and



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agencies, about 80% of the freelancers surveyed answered “yes”; for the Government, a remarkable 95% answered “no”.

This may or may not be fair: the Department for Business, Enterprise and Regulatory Reform, and its predecessor the DTI, have demonstrated a consistent support for the idea of labour market flexibility - to the well-publicised chagrin, and at times fury, of the trades unions. That said, it can be questioned whether the Department has truly grasped the nature and significance of freelancing in the UK.

The real source of freelancers’ astonishingly high levels of dissatisfaction is more likely the Treasury, whose design of tax policy over the last decade, coupled with the enforcement approach of the Inland Revenue and, latterly, HM Revenue and Customs, has unquestionably aroused great anger among freelancers.

PCG will therefore present its answer to this question in two sections: a consideration of tax-based obstacles to freelancing; and a consideration of other obstacles.

1) Tax-based obstacles to freelancing

a) IR35

IR35 (or more formally, the “intermediaries legislation”) applies when a worker supplies their services through a limited company or other corporate structure, plus an agency in many cases, to an end-client. It allows HMRC to “look through” the company and assess whether the underlying relationship between the worker and the end-client is one of employment.

If the worker is found to be a “disguised employee” the fee paid by the end-client to the contractor’s company is taxed as if it were a salary, with full PAYE income tax and employees’ NICs, plus employers’ NICs as well. Answering the counter-factual question (“if there were no company in the way, would this be an employment relationship?”) is a complex and difficult exercise in law. IR35 does not create an employment relationship: the worker is taxed as an employee but is not entitled to any of the rights usually associated with employment.

IR35 has created huge costs for freelancers. Most freelance businesses feel it is necessary to take out insurance against investigation for IR35: HMRC routinely investigates genuine businesses on suspicion of being disguised employees under IR35, thus obliging them to insure against the possibility. As an extra precaution, many contractors will pay to have any new contract professionally reviewed to ensure it is not IR35-caught; even when they don’t, they are obliged to waste a lot of time looking at their contracts for IR35 purposes.

Businesses who are investigated may be obliged to spend many years and hundreds, or even thousands, of pounds fighting off investigations if they are not insured. Even though freelance businesses will usually be found not to owe any money, resisting an aggressive HMRC investigation is expensive, time-consuming and distressing.

The Government has not monitored the impact of IR35: anecdotal evidence abounds, however, of freelancers closing their businesses because it makes them unviable, or even because IR35 investigations have put them out of business directly.

In his 2007 Budget, Gordon Brown removed a whole category of company structure (“Managed Service Companies”, or MSCs) from the scope of IR35 and applied a new tax treatment to them because IR35 could not be enforced.

The success of PCG members in demonstrating that they are not caught by IR35 suggests that when a contractor stands their ground, they will usually show that HMRC does not have a case against them: to date, of 1,554 IR35 investigations known to PCG, only 5 have been decided in favour of HMRC. These



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figures do not, of course, include businesses who have simply paid up due to wrongly believing themselves caught or simply to avoid a lengthy exchange with HMRC.

It is clearly unacceptable for taxpayers to be paying tax simply because the system is too complicated for them to be able to tell that they do not owe it, or because they do not want to deal with a lengthy and stressful investigation. The figures quoted above showing HMRC's enormous difficulty in implementing IR35 are far too clear-cut to represent a coincidence or statistical fluke: HMRC is clearly trying to pin IR35 on contractors who are not caught, either through ineptitude or a cynical attempt to extract tax that is not lawfully owed - neither of which should be tolerated from the UK's tax authority

HMRC's near-100% failure rate in investigations known to PCG clearly shows that IR35 is hopelessly complicated and that even the Revenue does not understand how to apply it. Under IR35, a contractor's tax bill can be determined by a contract they have never seen and to which they were not a party - the "upper contract" between their client and the agency. In a self-assessment system, this is plainly unacceptable.

The Government keeps no records of how much these fruitless investigations are costing the taxpayer, or of how many IR35 investigations are undertaken, successfully or otherwise. The Government's RIA of 1999 estimated that IR35 would generate an extra £220 million each year in NICs: yet Treasury ministers have confirmed to the House of Commons that they are unable to identify how much revenue is raised by IR35.

b) S660A and the Family Business Tax on "income shifting"

The Government has formed a view that, where a business is jointly-owned, it is not fair that its profits should be distributed in proportion to the ownership split. Instead, it feels that the profits should be distributed according to the "contribution" of each owner - or, if they are not, they should be taxed as if they are.

This is a bizarre stance: profits from a business are a reward for risk, whereas the Government wishes them to be treated in the same way as reward for labour.

Many freelancers who use limited companies own them jointly with others, usually their spouse: thus, their spouse is directly exposed to the commercial risks associated with the business. This applies to about a third of PCG members. The contributions of the spouse to the business vary: they can range from fee-earning work or extensive back-office support to smaller contributions, though it is unusual for a spouse to make no contribution to a business at all - as with any small business, those living in a household in which a business is being run cannot easily ignore it.

Where a company is owned jointly, it is possible that a tax saving may arise when profits are distributed to the two owners compared to what would have been paid if the profits had been distributed to only one person, by utilising the second person's nil-rate band. This is a natural reward for the exposure of the second person to commercial risk.

The Government has devised legislation aimed at what it calls "income shifting" - paying profits to second owners in order, as the Government sees it, to pay less tax. These proposals caused such a furore among businesspeople and tax professionals that the Government dropped them from the Finance Bill 2008, in which it had originally planned to introduce them, and has allowed a further year for consultation.

Much has been written elsewhere on this subject, but the key objections can be summarised thus: by denying the reality of many business structures, the measure would have unfairly penalised business arrangements that have been standard and accepted ever since the independent taxation of spouses was introduced in 1988; and they would have imposed enormous burdens of red tape on very small family businesses, as complying with the rules would have been extremely complex.



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This fiasco followed the attempt by the Inland Revenue, and later HMRC, to re-interpret the Settlements Legislation in order to achieve a similar tax outcome: this attempt was fought all the way to the House of Lords by PCG, which supported its members Geoff and Diana Jones, owners of Arctic Systems Ltd, in their test case.

At the time of writing, reports are circulating that the revised version of the “income shifting” rules will target freelancers explicitly: if true, this will represent a direct and discriminatory attack on the UK’s freelancers.

c) “S134” and agencies

There is a long-standing stipulation in tax law that self-employed sole traders must be taxed under PAYE if they find work via agencies and are under the direction and control of their clients: this dates back to the 1970s and can currently be found in s44-47 ITEPA 2003. Many freelancers refer to it as “s134” after a previous legislative incarnation. Although in theory sole traders can use agencies, in practice agencies will not deal with sole traders as a result of this measure: it exposes them to a considerable risk of liability for unpaid taxes.

This is the reason why so many freelancers use limited companies: while some would no doubt use the vehicle anyway, to make use of the limited liability it brings, it is likely that many would rather be sole traders. In PCG’s membership survey of 2006, 20% of PCG members indicated they would prefer to be sole traders.

d) Corporation Tax

The Government is very concerned about what it sees as “tax-motivated” incorporation: in other words, small businesses taking corporate form for reasons of tax advantage, but without any real commercial need.

While in theory such behaviour could indeed reduce the tax revenue flowing to the Government, the Government to a large extent has itself to blame. As we have seen, if a freelancer wishes to use an agency to find work, they have a commercial need to incorporate - this is a product of the tax system.

Other Government action has compounded this: by instigating a 0% starting band of Corporation Tax in 2002, Gordon Brown - then Chancellor of the Exchequer - directly prompted large numbers of people to incorporate for tax reasons.

In his final Budget in 2007, Gordon Brown announced a staged increase in the small firms’ rate of Corporation Tax to 22%, ostensibly to combat tax-motivated incorporation. While PCG doubts the sincerity of this reasoning, and notes that the Government has a clear need for cash at a time when its finances are tight, it must also be observed that this rationale is not merited: businesses have many legitimate reasons for incorporating, and by hitting all small companies equally, the Government is sending the message that it regards all small businesses as dishonest and intent on cheating the Exchequer. Unsurprisingly, the changes have caused great offence in the business world.

e) Managed Service Companies

Freelancers have numerous options when deciding what legal form to use. Limited companies and PAYE umbrellas have been discussed, as have the difficulties sometimes attaching to being a sole trader. Partnerships and limited liability partnerships are also used in small numbers.

Until 2007, there was a further option: a “composite company”, or “managed service company” as they have become known. A freelancer using one of these would be made a shareholder in a limited company, along with maybe a dozen or so other, unconnected, freelancers: the company would invoice for the freelancer’s services, and pay the freelancer in a mixture of dividends and salary. A scheme provider



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would operate as many MSCs as was necessary - numerous small companies were needed to utilise the small firms' CT rate.

This offered two principal advantages: administrative simplicity (also available via a PAYE umbrella); and a tax saving, by virtue of being paid by dividends (not available from umbrellas). To some people, this was a legitimate way for a freelancer to outsource the hassle associated with running a company; to others, it was a vehicle to avoid tax.

PCG took the latter view: freelancers using MSCs got the tax advantages of corporate form without taking on the full responsibility. In principle, therefore, we supported legislation in this area.

We disagreed with the Government about the rationale for this, however: the Treasury and HMRC perceived MSCs to be vehicles for "disguised employment". In fact, IR35 should still have applied to MSCs, and the fact that the Government felt the need to legislate demonstrates the failure of that measure.

The MSC legislation attempts to differentiate between "proper" limited companies and MSCs. For the most part it succeeds, but it is possible that a regular limited company could be deemed an MSC if its relationship with an accountant makes the accountant look like a scheme provider. There has been no case law on this subject so far, and it remains to be seen how much of a problem this will be in practice.

More seriously, the MSC legislation allows HMRC to pursue other parties for tax debts if the MSC itself is unable to pay - very often MSCs would be shut down and new ones opened in their place in the event of a tax demand. In particular, debt can be transferred to recruitment agencies: this has left agencies feeling very anxious, and has changed their behaviour in a way not intended by the Government. They are often extremely confused about what the rules mean, and can be unwilling to deal with contractors who have their own, perfectly legitimate, limited companies; even if they will deal with them, they often make them jump through needless "due diligence" hoops in order to check their MSC status.

Overall, the measure has caused great anger and uncertainty among recruiters and freelancers in affected sectors. While PCG believes that this will abate to some extent as case law develops and the scope of the legislation becomes clear, it must be observed that a clearer and simpler tax system would have avoided this outcome and the need for endless sticking-plaster tax measures.

f) Umbrellas

In Budget 2008, the Government announced that it will be examining the use of expenses by PAYE umbrella companies, which have attracted many more freelancers since MSCs were forced out of operation.

Many umbrellas operate with dispensations that allow freelancers to claim certain amounts in expenses against taxes without receipts, thus avoiding the need for a great deal of P11D-related red tape, both for the umbrella and for HMRC.

However, HMRC has a poor track record of enforcing these rules: for numerous years, disreputable operators have been operating without dispensations, or operating dispensations incorrectly - these have been open secrets, and HMRC has taken no action. In 2007, a well-known umbrella, Prosperity4, went bankrupt owing a lot of tax: it was phoenixed almost immediately as a new umbrella, called Tarpon.

HMRC's apparent willingness to let these companies get away with abusing the rules has emboldened them: many such companies make a point of advertising large potential tax savings in order to attract freelancers; some of these tax savings will be legitimate, but others will not.

HMRC are now looking at possible action in this area, but it is not clear what form this will take: while PCG members have no love for the less reputable type of umbrella, it is PCG's position that the existence



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of PAYE umbrellas is beneficial to the economy, as they allow people to try freelancing as a career, and to continue it without running a company if they so wish. If they were to be forced out of business, labour market flexibility would suffer, and freelancers would be left with fewer options: some will be more likely to turn to dubious offshore solutions, and make it even harder for HMRC to collect tax from them.

2) Non-tax obstacles to freelancing

a) Employment status

As has already been discussed, there is no definition in legislation of what makes someone an employee, or self-employed. Rules have been developed in case law, but they are not widely understood and can be complex to apply.

PCG has called for employment status to be defined in statute, so that there is a clear definition of who is, and who is not, an employee. The Government has consistently rejected this call.

The Government's justification for this is that its review of this issue produced a strategy document, 'Success at Work', that was published in 2006. They refuse to consider the matter again.

While PCG felt that 'Success at Work' contained many welcome recognitions of the value of flexible working, its understanding of freelancing was poor: it construed flexibility in terms of flexible working patterns within employment, and less in terms of freelancing and self-employment. Indeed, when Tony Blair gave a speech - punningly titled 'New Labour' - on the future of work in the UK shortly before leaving office, he did not mention self-employment at all, staggering though that might seem.

'Success at Work' also suffered from being out of date almost as soon as it was published: although it was billed as a strategy document for the 2005 parliament, the review gathered evidence in 2002 - in the early days of the 2001 parliament.

The document therefore missed numerous crucial developments since 2002, the first set of them being in case law itself. In the cases of *Dacas v Brook Street* and *Cable and Wireless v Muscat*, the Court of Appeal made it clear that tribunals and courts should infer implied contracts of employment where necessary, and look through any agency, limited company or other arrangements if appropriate. In February 2007, the Court of Appeal confirmed and honed this analysis in its judgment in the case of *James v London Borough of Greenwich*.

This development has left the clients of freelancers confused and anxious. A "48 week" rule has emerged at many: freelancers have their contracts terminated at 48 weeks or 11 months, as clients fear that once they have been working for 12 months they will be able to claim unfair dismissal.

This is a legal nonsense: no commercial contract can ever be turned into an employment one by a tribunal, provided it was a fair reflection of what actually happened. It is also a commercial nonsense: by terminating freelancers when there is work still to be done, clients will slow the work down and increase its cost as new freelancers have to be procured and given time to get up to speed.

Client organisations who have such a rule include, astonishingly, the Ministry of Defence. Other private-sector clients have publicly denied that such a rule is in place, although PCG has strong and credible intelligence to the contrary in some places. In PCG's membership survey of 2007, 7% of PCG members said they had had a contract terminated for this reason, while 16% had witnessed it. This is shocking: both figures should be zero.

It is also clear that employment status is a major problem for HMRC and the Treasury: the issue of "disguised employment" is central to IR35, the MSC legislation and potentially to future measures regarding umbrellas. It is clear that the Treasury and HMRC perceive a problem relating to employment status, as they keep seeking to correct its consequences.



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It is also clear that trades unions are unhappy with some workers being denied their rights because their employment status can be so easily obfuscated by unscrupulous employers.

The need to address employment status is therefore clear and urgent: the Government's persistent refusal to do so represents a striking sin of omission.

b) Procurement and security clearances

There are currently numerous obstacles that hinder freelancers in bidding for and winning procurement contracts: difficulties in tendering; the need to acquire security clearance for some work in the public sector; and the "48 week" rule, the last of these as described above in (a).

The principal difficulty for freelance contractors and consultants is that bidding for government contracts currently involves a lot of bureaucracy that is often unrelated to their ability to perform the work. The exact requirements for the format and content of tenders, and the processes involved, also tend to vary considerably between departments. Bidders are also usually required to have substantial funds available simply in order to be considered. The levels of insurance required are also completely prohibitive for SMEs. All of this militates against freelancers being able to bid.

In practice, therefore, prime contractors are invariably super-large consultancy firms, who may then sub-contract some or all of the work. This is not necessarily the best way of doing things.

Government projects, particularly IT systems but also engineering projects with which the Government is involved, for instance in transport infrastructure, have acquired a reputation for being completed late, over-budget and to a poor standard. Difficulties in managing them are regularly blamed: it is increasingly clear that these difficulties are caused, at least in part, by overly rigid procurement systems creating inappropriate and unworkable supply chains and management structures.

One way of solving the problems of inaccessibility for SMEs and poor management of major projects would be to allow for a freelancer to take a position high in the supply chain, between the department and the prime contractor and independent of each, in order to allow for independent oversight of the project. Many highly experienced project managers who work on a freelance basis already have similar strategic roles in major projects in the private sector.

Secondly, the application of procedures for acquiring security clearance are damaging to freelancers. Freelancers and contractors have found that agencies, prime contractors and government departments can be unwilling to consider freelancers who do not already have security clearance.

It is PCG's position that this practice makes no sense and is damaging: the available pool of resources for government work is artificially limited to those who have clearance, almost regardless of suitability; freelance workers cannot bid for government work on a level competitive basis, undermining efforts by the Government to open the market for such work to small businesses; procedures exist for allowing workers awaiting clearance to commence work while it is secured; and the time needed to obtain clearance is low and falling - there is therefore no justification for the practice of turning away applications on the basis that it would take too long to put contractors through vetting procedures.

This area is currently covered by guidance which the Government revised in 2007 with PCG's assistance, and which forbids the requirement of existing security clearance before a contractor can be considered for a role unless there is exceptional urgency.

Unfortunately this guidance is routinely ignored by agencies and public sector departments or prime contractors. PCG believes that an enforceable set of regulations is needed to ensure that the Government is able to procure the best expertise available.



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c) Skills, migration and offshoring

There is currently a serious disjoin between skills policy and migration policy in the UK. While the Government is seeking to raise the skills of the workforce and secure the UK's skills base for the long term, other developments are threatening its existence.

It is increasingly feasible to offshore high-skill work to lower-cost economies such as India. IT work is a prime example, but design and engineering work is also going offshore. The Government has indicated that it is in favour of this in principle, even though it has made no effort to quantify the impact of such developments on the UK's skills base.

As the offshoring of IT work has become widely-recognised, the attraction of IT as a career choice has diminished: research by E-skills UK has shown that the number of students choosing to study IT-related courses dropped by 43 per cent between 1996 and 2001. In an article in Computer Weekly in 2007, a careers consultant at the University of Manchester attributed this drop to students being put off IT courses "because of the perception that IT jobs are being offshored". The same logic seems to apply to all STEM (Science, Technology, Engineering, Maths) subjects.

In theory, offshoring brings benefit: companies make costs savings, which allow for further investment. But cost savings have to be significant for this to happen; very often, they are not. A survey in 2007 by research and consultancy firm AT Kearney for leading blue-chip companies found wide variations in the results achieved by firms offshoring business operations. Sixty per cent of firms surveyed failed to meet their operational performance expectations while thirty-four per cent failed to meet their savings expectations. Cost savings ranged from nought to seventy-five per cent, and while some firms achieved improvements across most of the operational performance areas studied, others saw a decline in performance in many areas.

Overall, then, high-skilled job losses are occurring as a result of offshoring - the Government has admitted as much - without any long-term investment in skills to make up for them.

Migration is central to this debate because it is necessary to bring people to the UK in order to achieve the knowledge-transfer necessary to send work offshore. While the Government has stated that it wishes to manage migration on the basis of economic need, it has so far shown a reluctance to apply this rationale to Intra-Company Transfers, which are the visas used to bring workers to the UK for these purposes. PCG is working with the officials developing the new Points-Based System to try to ensure that these visas will be controllable on the basis of economic need.

PCG's survey data shows that this phenomenon affects a significant but not enormous proportion of freelancers, but those who are affected by it are affected very badly: in 2007, 23% of PCG members identified it as a problem for their business (a high score was 25-30%), but 12% identified it as the biggest single problem they faced, making it the second-most common of all the "biggest problems" identified.

d) "Agency workers"

Freelancers are at risk of becoming entangled in the debate around "agency workers". In fact, this is one area where the Government's policies have generally been helpful: it has consistently resisted calls for employment rights to be imposed on workers who are not employees, both at European and UK level.

It can be observed, however, that trades unions are often hostile to any form of working that is not permanent employment, and can tend to assume - quite wrongly - that any workers who are not employees are vulnerable and being exploited. This is very clearly not the case for freelancers, and the Government must continue to ensure that employment obligations are not imposed on workers who neither need nor want them, and who would find them enormously damaging.



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e) Agency Regulations

There are two difficulties imposed on freelancers by the Government in respect to their relationships with agencies. The first is a set of regulations that need to be made to work slightly better; the second is a set of serious restrictions on how freelancers may use agencies.

To take the first issue first: the Government proposed to regulate the private recruitment agency industry in 2000. PCG took a keen interest in the proposed regulations and responded to several rounds of consultation. As a result of this dialogue, PCG was able to secure an opt-out for limited company contractors, which offers them flexibility without enabling unscrupulous agencies to force contractors to opt out.

The Conduct of Employment Agencies and Employment Business Regulations 2003 came into force in April 2004 and limited company contractors are within their scope.

The one fly in the ointment relates to the operation of the opt-out: under the regulations, it is unlawful for agencies to pressure workers to opt out, or remain opted in, which is fair. No such restrictions apply to clients, however, who at times stipulate that they would like a freelancer who has opted one particular way. This too should be made unlawful; the Government did not act on PCG's recommendation to this effect when consulting on amendments to the regulations in 2007.

More broadly, it is unlawful for most workers to be charged by agents who find them work: the end-user is the party who pays the agency. This has been the case since the 1970s, although certain types of worker, often in the cultural arena, are exempted from the regulations. The result is that, as he who pays the piper calls the tune, agencies tend to act in the interests of clients more than those of the work-seekers.

PCG would like to see consideration given to allowing broader categories of freelancer to have the choice of paying agencies to act on their behalf, as well as being able to find work through agencies paid by clients. This will allow agencies to meet freelancers' needs better. Careful thought would need to be given to the framing of this change, so that vulnerable workers may not be pressured into paying unscrupulous agents money to find them work, but we believe this should be eminently feasible.

What would be the effect on your organisation or others if, instead of using freelancers, you or they had to rely on permanent employees?

The effects of an absence of freelancers would manifest themselves differently depending on the type of strategy for which the freelancers are deployed by the client.

For example, freelance journalists allow publications to hire in particular specialisms as and when they are needed: if they were not available, the publication would have to maintain a team of all-rounders, who would no doubt still produce the necessary articles, but not to such a high standard as could have been achieved had the specialists skills and knowledge been available. Reducing the quality of the publication could well reduce its commercial success. The same principle can apply in other business contexts: without being able to bring in specialist expertise, businesses would have to rely on generalists who would not be able to complete the task to the same standard.

At other times, freelancers are brought in on a project basis: to install a new system or establish a new department, for instance. Without being able to bring in extra workers, companies would have to rely on their in-house staff, who would often have other responsibilities, and who again might not have the desired specialist skills. Projects would therefore take longer to complete, and be completed to a lower standard; there would be cost implications, as the project would take longer to complete and so its benefit would not be realised as early as it might have been. Alternatively, if the company decided to recruit new staff for the duration of the project, it would have the associated costs of laying them off once it was completed, and would be unable to dispense with them readily during the project if their performance was not satisfactory, or if the needs of the project changed.



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If all workers were employees, it can also be observed that there would be more employment disputes, as more workers sought to assert their rights. The Government would also feel more reluctant to extend such rights: as they would apply to all workers, they would act as a greater drag on the economy than they do at present.