



The voice of freelancing

PCG Position Paper: Employment Status

Summary

PCG's key policy demand is clarity in the law:

- confusion that has recently arisen in case law should be removed by statute, enacting and clarifying the current position established in common law
- difficulties in employment law should be addressed with employment legislation and not tax legislation
- as recommended by the International Labour Organisation in 2006, employment law should not interfere with commercial contracts
- PCG believes that such clarity can and should be achieved without impinging on protections rightly extended to vulnerable workers.

Introduction

PCG believes that all workers should have the right to be self-employed and to work on a freelance basis, if they wish to, and when it is commercially appropriate. A combination of factors including confused common law and bad practice by some companies means that this right is not always available or straightforward.

Freelance contractors and the self-employed should not be forced into employee status or quasi-employee status by the Government, clients or anyone else. End-users must therefore engage workers appropriately, either by an employment contract or a commercial contract, depending on the nature of the work in question.

Employment and tax status should ideally be indivisible: where work should be done by an employee, the worker should be engaged as an employee and given the appropriate rights; where work can be carried out on a commercial basis, the enterprise should be taxed as such, and neither expect employment rights and protections nor have them foisted upon it.

Employment and Freelancing

There has been a long-term trend towards granting rights and security to employees and vulnerable workers. In recent years, this trend has accelerated somewhat, with the introduction of a minimum wage, enhanced provisions for maternity and paternity leave, the Employment Agency regulations and so on. These are, of course, broadly positive developments.

Such provisions can, however, be burdensome for employers. When a business has a project of limited duration or requires a specialised set of skills for a limited period of time, it may be reluctant to take on an employee, with all the associated costs and obligations, for such a limited time. This is where freelance contractors and consultants step in: they are engaged on a business-to-business basis to supply the required services. They expose themselves to business risk by undertaking to cover their own sick pay, holiday pay, training, insurance, parental leave and so on, all from their fee and with no obligation on the client company. This form of working is essential to the continued expansion of employment rights: without it, greater rights for employees would be cripplingly burdensome for their employers.

The desirability of allowing for greater flexible working is widely acknowledged: discussions around the EU's Lisbon Strategy have repeatedly emphasised the need for flexibility and the Treasury's discussion paper 'Small companies, the self-employed and the tax system', published alongside the Pre-Budget Report of 2004, similarly noted the rise of increasingly flexible business arrangements.

The Government's 'Success at Work' strategy paper of 2006 acknowledged the value of flexibility in the economy and, although it construed this primarily in terms of enhanced employment rights and contained relatively little discussion of non-employment relationships, its decision not to advocate any change in the fundamentals of employment relationships in the UK indicates that the DTI is rightly wary of jeopardising the advantages offered to the economy by freelancing.

All the indications are that the trends towards flexible working, self-employment and freelancing are on the increase.



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Case law developments

A trend has recently developed in case law towards granting employment rights to workers who have not traditionally been thought to have any. The courts' logic is readily apparent: where an engagement is not commercial in nature but instead essentially an employment relationship, they pin employment obligations on the end-client. Unfortunately, while the logic is discernible, the law itself is not clear: it is impossible to say exactly what makes an engagement genuinely commercial and when employment rights are in fact owed.

This is deeply worrying for all involved with freelancing: contractors, agencies and end-users. It is causing some end-users to hesitate when taking on contractors and to make perverse decisions such as to terminate contractors at 48 weeks, irrespective of the amount of work left to be done or time remaining on the contract. This commercial uncertainty is therefore increasing costs and undermining the economic advantages offered by the UK's freelancing model.

The current confusion has arisen mainly as a result of recent employment status disputes, which are briefly outlined below.

Dacas v. Brook Street

Although Mrs Dacas was unsuccessful in her claim for unfair dismissal against her agency, Brook Street, *obiter* remarks by Court of Appeal judges suggested that she had probably been the employee of her end-user, Wandsworth Borough Council. The same judgment set out that in such situations tribunals should consider the possibility of an implied contract of employment, which they have since done in several cases. The judgment failed, however, to set out at what point in her engagement, why, or how, Mrs Dacas had become an employee, when at the outset she had been a PAYE agency worker. It is therefore currently impossible for an end-user to say with any certainty when an implied contract of employment arises.

Cable and Wireless v. Muscat

In line with the Dacas judgment, the Court of Appeal found in 2006 that Mr Muscat had had an implied contract of employment with Cable and Wireless, despite working through both a limited company and an agency. This was unprecedented and the judgment failed to give clear guidance on when it is "necessary" - in a legal sense - to infer an employment relationship in order to give "commercial reality" - a term left undefined - to an engagement.

James v. Greenwich Council

The Court of Appeal confirmed the decision in the Muscat judgment and clarified the strict terms necessary in order to infer a contract of employment between two parties from the nature of their relationship. The judge's conclusion allayed some of the concerns of end-clients about confusion in the law that had arisen as a result of the three-year long case, although it does not fundamentally make employment status transparent or readily understandable.

For such a simple business model - effectively the contractor's time in exchange for the client's money with no additional strings attached - it is surely unacceptable for employment status to be so confused.

ILO

In 2006 the International Labour Organisation recommended that employment law should not interfere with commercial arrangements. This offers a useful way of pinning down some of the distinctions between different types of working relationships.

Freelancers work on a commercial basis:

- they make contracts to provide services, but not to enter into the personal service of another person or organisation
- they are not under the direction and control of their end client, whereas an employee is
- there is no mutual obligation on either party to provide or perform work such as exists in an employment relationship.



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These three tests represent the key indicators of employment status in the United Kingdom, as currently set out in the common law.

It can be observed that many agency workers - typically those who do not work in a “freelance” mode - are obliged to work in a manner very like an employee when considered using the tests above. Freelancers, by contrast, operate in a commercial manner when assessed by these tests.

Disguised employment and IR35

i) The problem of disguised employment

PCG acknowledges that disguised employment is a problem in the United Kingdom and is keen that it should be addressed.

We understand the term “disguised employment” to relate to a scenario in which a worker is engaged to act in an employee-like manner, but is not employed by the company for which they are performing the services; instead, their contract takes a commercial form, denying them any employment rights.

This is a problem for two separate groups: genuine freelancers do not wish to provide their services in this way and are often inconvenienced by restrictive employee-like conditions in their contracts and for whom such terms threaten to confuse their employment and tax status. Other workers would rather have the protection of employment rights: for them, such a relationship is an abuse.

ii) IR35 - a failed attempt at a solution

When announcing the intermediaries legislation, or “IR35”, in 1999 the Treasury stated that its aim was to put an end to disguised employment. This rested on the critique that disguised employment is primarily tax-motivated and undertaken by individuals wishing to avoid tax: accordingly it penalised the workers by obliging them to pay full PAYE income tax plus employers’ and employees’ NICs on all fees paid to their limited companies (the “intermediary”) - a higher tax burden than faced by regular employees. Unfortunately this critique was mistaken: IR35 has failed to stop disguised employment, which remains a problem in the UK.

The main effect of IR35 has been that companies have been able to hire workers on a contract basis to undertake work that ought, by rights, to be done by employees. These workers are taxed more heavily than employees, receive none of the benefits of employment such as sick pay or holiday pay, can be dismissed at a moment’s notice and have no employment rights. In short, IR35 denies the protection of employment rights to those who need it and denies those who would otherwise prefer to manage without them the means to do so.

As this suggests, the key parties in such engagements are the end-clients: it works to their advantage to have workers whom they can control as employees but to whom they owe no employment rights and whom they can dismiss with the utmost ease. For freelancers, this distorts their commercial relationships; for employees, it is simply abusive.

It is PCG’s position that employment status issues in general, and disguised employment in particular, should be addressed by employment legislation and not tax legislation.

Possible solutions and reforms

To restore clarity to the law and remedy the problem of disguised employment requires action by the Government.¹

The alternative is to await further developments in case law, or even for an interested party to sponsor test cases to force such developments. However it is achieved, this would be a costly and lengthy process,

¹ See PCG’s Policy Briefing on Agency Workers for PCG’s position on any proposed change to the current balance of rights and freedoms, available on www.pcg.org.uk



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with no guarantee of an amelioration in the situation. In the years this would take to achieve, the commercial uncertainty created by the ambiguity in the law would continue to hinder the UK's economic performance. This surely cannot be right: the Government should consider how it can act to remedy the situation.

Inevitably such action must involve statute - the constitution provides no alternative. This is a difficult course, but it offers the only solution.

On reflection, it is indeed surprising that such a fundamental issue as the legal status of an individual as they earn their living has been left to common law for so long: while it offers flexibility in allocating rights precisely in a given case, it also risks ambiguity and instability. When the Employment Status Review consulted in 2002, this balance was being struck successfully: by 2006, this was no longer the case.

For the UK's economy to prosper, the businesses and individuals operating within it require clarity and certainty in the law: this must be introduced via statute.

The fundamental purpose of any measure would be to codify the courts' logic and thereby make it readily comprehensible and easily enforceable.

It must be emphasised that this would not change the fundamental legal position: the courts have already extended employment rights in this regard, but enforcing this is, for most workers, an impossibility. The first recourse for workers denied their rights should not be legal action: the law should be sufficiently clear that this is not necessary.

ii) Adoption of best practice

It is vitally important that business-to-business practices are appropriately used when hiring workers on a commercial basis - companies could be encouraged to adopt best practice in this regard. When contractors are engaged, they should be hired on genuine business terms: companies should not be offering them contracts which include direction and control, or integrating them within their structures. If a contractor is hired as an external supplier, they should be treated in all respects as such. It is therefore vitally important that efforts be made to educate end-users to this effect.

PCG offers template contracts which are sound for both these purposes. All agency contracts and notes are freely available to download from PCG's website and their use is not restricted to PCG members. PCG also offers accreditation to agencies via its Approved Contract Scheme. Contracts which display the Approved Contract Scheme logo have been vetted by PCG's legal experts and are passed for use.

Green Paper

In November 2006 the European Commission adopted a Green Paper entitled 'Modernising Labour Law to Meet the Challenges of the 21st Century'. The document framed its discussion without fully recognising some basic commercial and legal realities, such as the existence of the two different types of working contractual relationship, namely employment contracts and commercial contracts.

The Green Paper's failure to recognise this basic distinction has led to much ambiguity and misunderstanding within it. PCG is extremely concerned at the prospect of any legislative proposal based on such a garbled understanding of modern ways of working. Not only would it be extremely dangerous if done badly, but PCG must also question whether such a measure should be countenanced at EU level at all.