Employer Update

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New Restrictions on Using Earnings History to Set Compensation

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Some jurisdictions have begun restricting the practice by many employers of considering applicants' earnings history when setting compensation. Those in favor of such measures maintain that when employers consider prior earnings, "women often end up at a sharp disadvantage and historical patterns of gender bias and discrimination repeat themselves, causing women to continue earning less than their male counterparts." A.B. 1676, Cal. Leg. (2016). Several federal appellate courts have discussed a related issue—whether the Equal Pay Act already prohibits sole reliance on prior earnings to explain a wage differential challenged under the Act. In this article, we outline the circuit split on this issue, summarize recent measures in California, Massachusetts, and Philadelphia restricting the use of prior earnings, and provide guidance for employers seeking to maintain compliant hiring and pay practices.

Background

The Equal Pay Act prohibits employers from discriminating on the basis of sex by paying less in wages to employees than it pays those of the opposite sex for equal work on jobs requiring "equal skill, effort, and responsibility, and which are performed under similar working conditions." One exception is when the wage differential is "based on any other factor other than sex." 29 U.S.C. § 206(d)(1).

Courts are split on whether the EPA prohibits wage differentials based *solely* on prior earnings, as a "factor other than sex." In *Wernsing v. Department of Human Services*, 427 F.3d 466, 468-70 (7th Cir. 2005), the Seventh Circuit recognized that "[i]f sex discrimination led to lower wages in the 'feeder' jobs, then using those wages as the base for pay" would violate the EPA. But, in affirming summary judgment for an employer, the court held that plaintiffs must prove, rather than assume, that prior wages were discriminatory, noting that the plaintiff in that case had not offered expert evidence, or cited any economics literature, to support an argument that the organizations from which her employer hires discriminate in wages on the basis of sex. The court also rejected the argument that the "factor other than sex" must be an "acceptable business reason," holding that the EPA only requires employers to have a reason "other than sex," not necessarily a "good" reason.

In *Taylor v. White*, 321 F.3d 710, 719-20 (8th Cir. 2003), the Eighth Circuit similarly declined to prohibit sole reliance on prior earnings in all cases,

concluding from the EPA's legislative history that this practice "may serve legitimate, gender-neutral business purposes, such as the retention of skilled workers who may be needed in the future to perform higher level work." Accordingly, courts should conduct a "case-by case analysis" to "search for evidence that contradicts an employer's claims of gender-neutrality."

By contrast, both the Sixth and the Eleventh Circuits concluded that sole reliance on prior salary to justify a wage differential violates the EPA. *See Balmer v. HCA, Inc.*, 423 F.3d 606, 612 (6th Cir. 2005), *overruled on other grounds by Fox v. Vice*, 563 U.S. 826 (2011); *Irby v. Bittick*, 44 F.3d 949, 955 (11th Cir. 1995). Drawing on a district court's analysis, the Eleventh Circuit explained in *Irby* that "[i]f prior salary alone were a justification, the exception would swallow up the rule and inequality in pay among genders would be perpetuated." Under that circuit's precedent,

Effective January 1, 2017, California employers may no longer rely solely on employees' prior salaries to "justify any disparity in compensation," codifying in the California Labor Code the Sixth, Tenth, and Eleventh Circuits' interpretation of the EPA.

based on the EPA's legislative history, "the 'factor other than sex' exception applies when the disparity results from unique characteristics of the same job; from an individual's experience, training, or ability; or from special exigent circumstances connected with the business." *Glenn v. Gen. Motors Corp.*, 841 F.2d 1567, 1570-71 (11th Cir. 1988). In the same vein, the Tenth Circuit concluded in an unpublished decision that although the EPA precludes sole reliance on prior salary to justify a pay disparity, employers may consider prior salary in conjunction with applicants' qualifications and experience. *Angove v. Williams-Sonoma, Inc.*, 70 F. App'x 500, 508 (10th Cir. 2003).

In summarizing this circuit split, a California district court found that although the Ninth Circuit held in *Kouba v. Allstate Insurance Company*, 691 F.2d 873, 876-77 (9th Cir. 1982), that "the Equal Pay Act does not impose a strict prohibition against the use of prior salary," the circuit did not decide whether prior earnings alone can justify a salary differential under the EPA. Instead, after concluding that employers must have an "acceptable business reason" for using a factor that causes a wage differential between male and female employees, *Kouba* held that "the employer must use the factor reasonably in light of the employer's stated purpose as well as its other practices." The court believes this standard accommodates employer discretion while also protecting against the risk of employers using prior salary "to capitalize on the unfairly low salaries historically paid to women." The California district court followed the Sixth, Tenth, and Eleventh Circuits and, in denying summary judgment to an employer, held that basing compensation solely on prior wages carries too high of a risk that "it will perpetuate a discriminatory wage disparity between men and women," and thus this practice, even if supported by a legitimate, non-discriminatory business reason, violates the EPA. *Rizo v. Yovino*, 2015 WL 9260587, at *8-9 (E.D. Cal. Dec. 18, 2015).

New Measures

California, Massachusetts, and Philadelphia have recently enacted legislation that expressly addresses the issue of employer use of applicants' earnings history in setting compensation. Under California Labor Code § 1197.5(a)(1)(D), employers may not pay employees less than other employees of the opposite sex for substantially similar work, except when they demonstrate that the wage differential is based on one or more of certain factors, including a "bona fide factor other than sex, such as education, training, or experience." Effective January 1, 2017, California employers may no longer rely solely on employees' prior salaries to "justify any disparity in compensation," codifying in the California Labor Code the Sixth, Tenth, and Eleventh Circuits' interpretation of the EPA. § 1197.5(a)(3). New York Labor Law does not contain this explicit prohibition; however,

the state's Achieve Pay Equity Act, effective January 19, 2016, similarly limits the "catch-all exception" to the equal pay requirement to differentials based on a "bona fide factor other than sex, such as education, training, or experience." N.Y. LAB. LAW § 194(1)(d). It remains to be seen whether New York courts will consider prior earnings to fall within this exception.

Beginning July 1, 2018, Massachusetts employers are subject to even more restrictions. Under the Act to Establish Pay Equity, employees' previous wage or salary histories will not be a defense to an action for wage discrimination on the basis of gender. The law also prohibits employers from asking an applicant, or her current or former employer, for the individual's wage or salary history, and from requiring that an applicant's earnings history meet certain criteria. But if an applicant volunteers her wage or salary history, the employer may confirm such information. Likewise, once the employer has negotiated and made an offer of employment with compensation, it may then seek out or confirm an applicant's wage or salary history. The Massachusetts law broadly defines "wages" to include "all forms of remuneration for employment." MASS. GEN. LAWS ch. 149, § 105A(a)-(b), (c)(2).

A Philadelphia ordinance will similarly restrict employer inquiries into applicants' wage histories. Effective May 23, 2017, Philadelphia employers may no longer inquire about or require disclosure of applicants' wage histories, or condition employment or consideration for an interview or employment on disclosure of wage history. Employers also will no longer be able to rely on applicants' wage histories in determining wages "at any stage in the employment process, including the negotiation or drafting of any employment contract." The ordinance defines "wages" to mean "all earnings of an employee … including fringe benefits, wage supplements, or other compensation." Similar to the Massachusetts law, there is an exception for when applicants "knowingly and willingly" disclose their wage histories. B. No. 160840, Phila. City Council (Pa. 2017).

A private right of action exists to enforce each of these measures. Philadelphia requires exhaustion of administrative remedies, unlike California and Massachusetts. PHILA., PA. CODE § 9-1122(1). In California, employees may bring an action within two years, or three if the violation is "willful," for wages due, including interest, and an equal amount of liquidated damages. California also provides a separate cause of action for an employee "who has been discharged, discriminated or retaliated against, in the terms and conditions of his or her employment because the employee engaged in any conduct delineated" in § 1197.5. The employee must bring the action within one year, and may recover reinstatement, reimbursement for lost wages and benefits, including interest, and "appropriate equitable relief." § 1197.5(h)-(i), (k)(2)-(3). A Massachusetts employee has three years to sue for unpaid wages and an equal amount of liquidated damages. § 105A(b)-(c). After exhausting administrative remedies, Philadelphia employees may recover "any relief [the court] deems appropriate," including compensatory and punitive damages, and injunctive relief. Separate penalties in Philadelphia include up to $2,000 for each violation, and, for repeat violations, potential imprisonment for up to ninety days. § 9-1121, 1122(3). Each jurisdiction also authorizes recovery of reasonable attorneys' fees and costs. § 1197.5(h); § 105A(b); § 9-1122(3).

Employers should remain current on proposals in this rapidly evolving area of the law so they are prepared to make any necessary revisions to their hiring and pay practices.

Practice Pointers

Legislators in New Jersey and Texas have proposed similar bills, and the Public Advocate for the City of New York proposed legislation in 2016 that would prohibit all city employers[1] from requesting applicants' salary history. Employers should remain current on

proposals in this rapidly evolving area of the law so they are prepared to make any necessary revisions to their hiring and pay practices. They also may wish to consider:

- For national employers, using earnings history to set compensation in conjunction with other legitimate criteria, such as experience, except to the extent applicable to prospective employees in Massachusetts and Philadelphia, which, as noted above, restrict employers' ability to request earnings history. If having multiple hiring and pay policies presents an administrative burden, employers may wish to consider adopting a uniform policy that conforms with Massachusetts and Philadelphia law.
- Educating and training those participating in hiring and compensation setting, including any third party involved in recruiting and verification of prior employment, on these new limitations and any corresponding changes in company policy. Because these new measures have anti-retaliation provisions, employers should also update their anti-retaliation policies and train employees accordingly.
- Performing an analysis of the company's workforce to determine whether any pay disparities exist between employees of the opposite sex performing the same job. Employers should involve counsel in this process to increase the likelihood that the attorney-client privilege and the work product doctrine will protect the analysis and any related communications and materials from disclosure.

1. Mayor de Blasio signed an executive order in 2016 prohibiting city agencies from inquiring into applicants' pay history, and Governor Cuomo signed an order this year imposing similar restrictions on state entities.

The Gig Economy: Shifting Sands in Employment Status

By Ivor Gwilliams, Simon Gorham and Aron Joy

Broadly speaking, an individual working in the UK can be categorised as either:

- An employee.
- A worker.
- A self-employed person (often referred to as a consultant or independent contractor).

How these different categories are defined, what their defining characteristics are and what rights and protections are, or should be, afforded to each of these categories has been the subject of much recent debate. This debate has been sparked, in part, by the recent employment tribunal claims brought by individuals working in the so called "gig economy" (also known as the on-demand, or sharing, economy) and also by the widely reported claims that low-paid workers, particularly, but not only, those on zero-hours contracts, are being exploited and denied rights and protections that they ought to enjoy (*see boxes "Recent decisions" and "Reliance on self-employed persons in the gig economy"*).

The government has launched several inquiries in this area investigating whether the current legal framework concerning employment status remains fit for purpose (*see "Government and other inquiries" below*).

This article considers:

- The different employment status categories and the protections that apply to them.
- Taxation.
- The use of self-employed persons in the gig economy.
- The recent employment tribunal and court cases brought by workers in the gig economy.
- Some practical tips on how to construct and document self-employed relationships.
- Current inquiries on employment status and the gig economy.

Recent decisions

A number of individuals engaged by gig economy companies have brought claims arguing that the terms and conditions of their work mean that they are not self-employed but rather are workers, who therefore should receive rights and benefits such as the national minimum wage or national living wage and holiday pay.

Uber

One of the most high-profile claims so far was brought by 19 drivers against Uber (*Aslam and others v Uber BV and others ET/2202550/15; see News brief "Employment status and the gig economy: a drive for workers' rights", www.practicallaw.com/5-636-2120*). Of the 19 drivers, two were put forward at a preliminary stage of the proceedings to act as lead claimants. On 28 October 2016, an employment tribunal ruled that the two drivers are workers for employment law purposes. The tribunal rejected Uber's argument that the drivers were working directly for the customers and that the Uber app merely facilitated that work or provided a platform for drivers to contract with customers.

Personal service was not an issue in this decision, but the degree of control exercised by Uber over its drivers was key to the tribunal's decision. The tribunal found that Uber dictated various aspects of the work carried out by its drivers.

Significant factors that pointed towards the drivers having worker status were the fact that Uber:

- Reserves the power to amend its drivers' terms unilaterally.
- Requires drivers to accept or not to cancel trips, or both, on Uber's terms.
- Imposes numerous conditions on drivers instructing them how to do their work and controlling them in the performance of their duties; for example, fixing the fare, setting the default route for each trip, strongly discouraging deviations from the default route and limiting the choice of acceptable vehicles.

Types of Working Arrangements

While there are statutory definitions of employee and worker, these are not, in themselves, helpful in determining whether an individual is an employee or a worker, as opposed to a self-employed person. Rather, a judgment based on the facts in each case must be made.

Employee

There are two main definitions of employee for employment law purposes. The first determines whether an individual enjoys certain rights such as unfair dismissal rights (*sections 203(1) and (2), Employment Rights Act 1996*) (ERA) (section 203). The second, wider, definition determines whether an individual enjoys protection from discrimination (*section 83(2), Equality Act 2010) (2010 Act)* (section 83(2)).

Section 203 defines an employee as an individual who has entered into or works under, or, where the employment has ceased, worked under, a contract of employment. A contract of employment is a contract of service or apprenticeship, whether express or implied, and if it is express, whether oral or in writing. It is to be distinguished from a contract under which a person gives service as an independent contractor under a contract for services.

Three primary factors must exist to establish employment status, as well as a range of other factors:

Mutuality of obligation. The employer must be obliged to provide work and the individual must be obliged to accept and carry out the work in return for pay. There must be a minimum degree of commitment on both parties.

Personal service. This means that the individual is obliged to perform work personally in return for a wage or remuneration and is not permitted to use a substitute to perform the work or to subcontract the work.

Control. The employer must exercise sufficient control over the employee and the way that he performs the work, including when, where and how. An employer will normally exercise this control by giving directions to the employee and invoking

Recent decisions (continued)

- Subjects its drivers to a rating system, which is effectively a performance management and disciplinary procedure.
- Determines issues about rebates, sometimes without involving the driver whose remuneration is liable to be affected.
- Bears losses, for example, when there has been a fraud or where Uber has refunded a customer in circumstances where the driver is not at fault, which if the drivers were genuinely in business on their own account would fall on them.
- Handles passenger complaints.
- Interviews and recruits drivers.
- Controls key information, in particular, details about the passenger's identity and intended destination, which it does not share with its drivers.

Uber has appealed the decision, arguing, among other things, that the tribunal was wrong to:

- Disregard the written contracts on the basis that they did not reflect the reality of the situation and to disregard the basic principles of agency law with which the operation of the written contracts were consistent.
- Take into account features of the contractual relationship between Uber and the drivers that are required by the relevant licensing regime governing private hire vehicles
- Make certain findings of fact, for example, Uber contends that drivers are not required to accept trips or not to cancel trips when they have the Uber app switched on.
- Fail to take into account relevant factors that point away from worker status. For example, drivers: pay a service fee to use the Uber app; supply their own vehicles; fund their private hire licences; and are free to work for other organisations including direct competitors.

disciplinary proceedings if the employee fails to carry out the directions. In contrast, a self-employed person will typically have greater freedom to decide how and when to work.

Often, the level and nature of the control exercised by the purported employer will be one of the most carefully scrutinised factors, particularly in cases where the mutuality of obligation and personal service tests are relatively easy for the individual to pass. However, no single factor will be determinative and the courts will take into account other factors, including:

- Whether the individual is in business on his own account, taking financial risk and having the opportunity of either receiving profits or profiting from sound management.
- Whether the individual provides his own tools or equipment.
- The extent to which the individual is integrated into the business of the purported employer.
- The nature and duration of the individual's engagement.
- The pay and benefits received by the individual.

While the courts will look at the written contract between the parties and also the labels given by the parties to each other, for example, whether they refer to themselves as employee and employer or client and consultant, the courts will not be swayed by this alone. They will look at the entire factual situation when determining the nature of the relationship, as the Supreme Court has held that employment tribunals may disregard terms included in a written agreement where they do not reflect the genuine agreement of the parties (*Autoclenz Ltd v Belcher and others, www. practicallaw.com/5-507-8331; [2011] UKSC 41*) (*see box "Practical tips to ensure self-employed contractor status"*).

Worker

A worker sits somewhere between an employee and a self-employed person. The most commonly used definition of a worker is an individual who has entered into, or works under, a contract of employment or any other contract, whether express or implied and, if it

Recent decisions (continued)

CitySprint

On 6 January 2017, an employment tribunal held that a cycle courier, Ms Dewhurst, was a worker of a courier company, CitySprint (*Dewhurst v CitySprint UK Limited ET2202512/2016; www.practicallaw.com/3-639-2868*). This is the first of four claims being brought against courier companies (the other companies being Excel, Addison Lee and eCourier). As in *Aslam*, the tribunal ruled that the contract, which purported to treat Ms Dewhurst as a self-employed contractor, simply did not reflect the reality of the situation. The contract provided that: CitySprint had no obligation to provide work; Ms Dewhurst had no obligation to accept work; Ms Dewhurst could send a substitute in her place to do her work provided that the substitute could carry out the work; Ms Dewhurst would not get paid if she did not work; and she would not receive holiday, maternity or sick pay or other employment benefits.

The tribunal found that, in practice, Ms Dewhurst: was required to log into the company's GPS tracking system when she was working; was required to wear a uniform; was expected to take on jobs that came up once she had logged into the system unless there was a good reason for not doing so rather than having any discretion as to which jobs to perform; and was directed throughout each working day by a controller through radios and mobile phones as to how to perform the work and had little autonomy in this regard.

The tribunal held that she was integrated into the business of CitySprint and was a worker during the periods when she was logged into the company's GPS system. As for the personal service test, the tribunal held that the right, such as it was, for Ms Dewhurst to substitute another person to perform the work could not be, and never was, exercised because, in reality, only another CitySprint courier could perform the work. In effect, Ms Dewhurst could only ask for jobs to be allocated to other colleagues rather than to a substitute of her choosing.

is express, whether oral or in writing, under which the individual undertakes to do or perform personally any work or services for another party to the contract whose status is not by virtue of the contract that of a client or customer of any profession or business undertaking carried on by the individual (*section 230(3)(b), ERA; regulation 2(1), Working Time Regulations 1998 (SI 1998/1833)*) (WTR) (section 230).

Unless the individual has a right to substitute another person to provide the services, the personal service requirement will usually be satisfied. In that case, the analysis will often focus on the extent to which the individual is subordinate to the person to whom he is providing his services and the extent to which the individual is integrated within the purported client's business, although subordination is not necessarily an essential element of worker status and one must look at all the facts of the situation and apply them to the words of the statutory definition (*Clyde & Co LLP and another v Bates van Winkelhof [2014] UKSC 32; see News brief "Whistleblowers: protection for LLP members", www.practicallaw.com/0-572-1145*).

The Supreme Court in *Clyde & Co* pointed out that, for example, a small business may be genuinely an independent business but be completely dependent on, and subordinate to, the demands of a key customer, whereas a professional person with a high degree of autonomy as to how the work is performed could still be so closely integrated into the other party's operation as to constitute a worker.

Following *Secretary of State for Justice v Windle and Arada*, the courts will now allow the existence or absence of mutuality of obligation to be considered as a factor in determining worker status (*[2016] EWCA Civ 459; www.practicallaw.com/2-630-2627*). This has lead critics of the current state of the law to argue that, effectively, the same tests are now used to determine worker status as for employment status, making it even more difficult and uncertain to determine the status of a worker.

An individual who satisfies the test for being a worker but not an employee (on the narrow definition of employee for unfair dismissal purposes under section 203) will also satisfy the test for being an employee for discrimination purposes under section 83(2). This

Recent decisions (continued)

Deliveroo

A group of north London Deliveroo riders has adopted a slightly different tactic. The riders are represented by the Independent Workers Union of Great Britain, which has made an application to the Central Arbitration Committee (CAC) to be recognised for collective bargaining purposes in relation to this group of riders. The application will only succeed if the riders constitute workers for the purposes of section 296 of the Trade Union and Labour Relations (Consolidation) Act 1992 (TULRCA).

While the definition of workers under TULRCA is different from the definition of worker under section 230 of the Employment Rights Act 1996 (section 230) for the purposes of entitlement to benefits under the Working Time Regulations 1998 (*SI 1998/1833*) and other benefits afforded to workers such as the national minimum wage and national living wage, it is very similar (*see "Protection and rights" in the main text*).

Therefore, if the CAC rules that the riders are workers for the purposes of TULRCA, it should not be too difficult for the riders to convince a tribunal that they are also workers for the purposes of section 230. For this reason, the application has been seen as a back-door way of securing worker status. Some Deliveroo riders are understood to be also considering bringing an employment tribunal claim for worker status.

Pimlico Plumbers

On 10 February 2017, the Court of Appeal found that a plumber, Mr Smith, was a worker and also an employee for discrimination purposes (*Pimlico Plumbers Ltd and Mullins v Smith [2017] EWCA Civ 51; see News brief "Worker status: a busted flush?",www.practicallaw.com/3-639-2689*). The court found that the personal service test was satisfied as Mr Smith was required to perform the work personally. In addition, as in *Aslam*, the degree of control exercised by Pimlico Plumbers and the

is because section 83(2) defines an employee as an individual who is employed under a contract of employment or a contract personally to do work. In *Clyde and Co*, a contract personally to do work was held to mean, in essence, the same as the second part of the worker definition.

Self-employed person

There is no legal definition of a self-employed person but, by default, an individual who provides his services to another person and does not satisfy the tests for employee or worker status will be regarded as self-employed for employment law purposes.

The elements of mutuality of obligation and personal service will be missing from a genuine client-contractor relationship. Self-employed persons will be in business for their own account and may either engage with the client in their personal capacity or through limited companies or partnerships that they own or control. A self-employed person often takes on some level of financial risk and he may be required under his contract with the client to correct unsatisfactory work at his own expense. The genuinely self-employed person will typically have discretion over how, when and where the work is carried out.

Protection and rights

The distinction between the three main categories, that is, employees, workers and self-employed persons, is important because different statutory protections and benefits are afforded to each category.

Self-employed persons enjoy the fewest statutory protections. They are protected by laws concerning workplace health and safety, data protection rights, discrimination and whistleblowing protection.

Workers are eligible for the same rights as self-employed persons as well as:

- Rights under the WTR such as rest breaks and paid annual leave.
- The national minimum wage and the national living wage.
- The right not to have unlawful deductions made from their wages.

Recent decisions (continued)

integration of Mr Smith within Pimlico Plumbers were inconsistent with Pimlico Plumbers being a customer or client of a business run by Mr Smith.

Mr Smith was required to be available to take on work for a minimum of 40 hours each week on days that had to be agreed with Pimlico Plumbers. Pimlico Plumbers did not have to offer Mr Smith work if there was no work available and Mr Smith was not obliged to take on any particular job if he was unable or unwilling for any reason to do so. The court placed weight on a number of factors including: the restrictions on Mr Smith's ability to work for other companies; and the requirements that he use a branded company van and wear a Pimlico Plumbers uniform. The court also found that the tribunal had been entitled to place some weight on the existence of restrictive covenants in the contract which prevented Mr Smith from working as a plumber in any part of Greater London for three months after termination.

In this decision, the personal service test was a key issue. The court ruled that Mr Smith had no express or implied unfettered right to substitute someone else to perform the work. Although there was a practice of Pimlico Plumbers allowing its operatives to swap jobs between themselves, this was more akin to swapping a shift between workers than a self-employed contractor's right of substitution.

Helpfully, the court set out clearly the circumstances in which a right for an individual to substitute another person to perform the work will be consistent or inconsistent with the personal performance element required to establish worker status. A right of substitution which is unfettered, or only fettered by a condition that the individual needs to show that the substitute is as qualified to perform the work, is inconsistent with the individual being a worker. However, if the right of substitution is subject to conditions, it will depend on the extent to which the right is limited or occasional. For example, if the individual can only exercise the right of substitution when he is unable (for example, due

- The right to be automatically enrolled in a pension scheme.
- The right not to suffer detriment for exercising rights in respect of trade union membership.

Employees enjoy the most protection. As well as the same rights enjoyed by workers, they are entitled to unfair dismissal rights, redundancy pay, statutory notice, and family-friendly leave, subject, in relation to certain rights, to satisfying service requirements.

Taxation

HM Revenue & Customs (HMRC) uses employment status to determine among other things:

- The amounts and timings of payments of income tax and National Insurance contributions (NICs).
- Entitlement to statutory payments under the Social Security Contributions and Benefits Act 1992, for example, incapacity benefit and state maternity allowance.
- Eligibility for certain tax-related expenses and deductions.

HMRC also uses employment status to determine whether, for example, the employment-related securities regime and disguised remuneration rules (the latter being, broadly, a regime for taxing what is effectively employment income provided through third parties) contained in Parts 7 and 7A respectively of the Income Tax (Earnings and Pensions) Act 2003 apply to an individual's arrangements.

In doing so, HMRC uses two main categories of employment status: employed and self-employed. There are also various other subcategories for tax purposes which apply to specific groups such as agency workers and apprentices.

HMRC does not recognise worker status. A worker for employment law purposes may be taxed either as an employee or a self-employed person. Therefore, it is possible to be self-employed for tax purposes but still be classed as a worker for employment law purposes; a point that is becoming increasingly relevant given the development of the gig economy.

Recent decisions (continued)

to illness) to perform the work or if the client agrees, it will not prevent the individual arguing he is a worker, unless there are any exceptional facts to the contrary. It will be interesting to see if claims brought by other gig economy workers try to take advantage of the guidance in *Pimlico Plumbers*.

Reliance on self-employed persons in the gig economy

The last ten or so years have seen the emergence and growth of the gig economy. This economy, driven by the digital revolution, is characterised by companies which offer access to platforms that connect customers with providers of goods or services such as Uber, Etsy, Airbnb, Taskrabbit and delivery companies such as Hermes, CitySprint and Deliveroo, to name but a few of the more well-known companies. The business model of many of these companies relies on engaging individuals to provide goods or services directly to customers as self-employed contractors, rather than as employees. The benefits for companies of engaging self-employed contractors are significant: they are cheaper and more flexible; they only need to be paid for the work that they perform, not for their time; and they do not need to be paid holiday pay, the national minimum wage or national living wage. From a tax perspective, employer's National Insurance contributions are not chargeable in respect of fees paid to self-employed persons.

Having a pool of self-employed contractors enables a business to scale up quickly and efficiently in busy periods to satisfy customer demand. Indeed, one of the hallmarks of the gig economy, and no doubt one of the keys to its success, is that it directly links customer demand to the supply of workers.

Critics argue that gig economy companies engage self-employed persons in order to avoid having to provide certain statutory rights, benefits and

HMRC tests

While there is a large degree of overlap in the principles that the employment tribunals and tax tribunals use when determining status, the tax and employment regimes are separate, and the case law that applies the relevant factors and decides employment status for employment law purposes does not, unsurprisingly, do so for tax purposes and vice versa.

Online tool

HMRC has an online employment status indicator tool (ESI) to enable the employment status of an individual or group of individuals to be checked (*http://tools.hmrc.gov.uk/esi/screen/ESI/en-GB/summary?user=guest*). The outcome of the ESI can be relied on as evidence of an individual's status for tax purposes provided that the check has been carried out by the engager (that is, the business engaging the individual's services) or its authorised representative and that the answers provided accurately reflect the terms and conditions under which the individual provides his services. If the tool is used by or on behalf of the individual, rather than the engager, the result is merely indicative. However, as case law shows, identifying employment status is not straightforward and reliance on the tool alone is unlikely to be enough.

Gig economy challenges

The way in which services are provided in the gig economy does not change the test for determining whether an individual is employed or self-employed for UK tax purposes. However, it presents challenges in how those tests are applied and some commentators have suggested that the tax system needs to recognise a third way of working.

A re-evaluation of employment status for tax purposes is, in part, being driven by the practical issues of collecting tax and enforcing its payment, both of which are made significantly easier when dealing with an employer as opposed to an individual. In addition, classifying workers in the gig economy as self-employed for tax purposes leads to significantly lower tax revenues; in the Autumn Statement 2016, the

Reliance on self-employed persons in the gig economy (continued)

protections to individuals who deserve them. The perception of exploitation of low-paid workers in the gig economy comes at a time when other companies, such as Sports Direct and Hermes, have also been in the firing line for working practices that are seen as oppressive, including the use of zero-hours contracts and payments to self-employed contractors that allegedly fall below the equivalent of the national minimum wage.

In contrast, defenders of gig economy companies argue that this business model merely takes advantage of a new generation of workers who want to work more flexibly outside the constraints of a typical "9 to 5" job in order to service the demands of customers who now expect to be able to order goods and services through an app.

Practical tips to ensure self-employed contractor status

Despite the complex set of legal tests to determine employment status and the inherent uncertainty of fact-sensitive court and tribunal decisions, it is nevertheless possible to provide some practical tips for companies wishing to engage individuals as genuine self-employed contractors rather than as employees or workers:

- Always document the relationship in a written contract with the individual to evidence the parties' intention to create a contract for the provision of services and not a contract of employment.
- Where possible, make it clear that there is no obligation on the client company to provide work to the individual and no obligation on the individual to perform the work. Clearly, this may not be commercially possible in many cases; the client may need certainty that the work will be done if requested. However, if an individual has the ability to turn down work as and when he pleases, this will support the argument that the individual cannot be a worker or an employee.

Office for Budget Responsibility estimated that the gig economy will cost the Treasury £3.5 billion in 2020/21 in lost tax revenues.

A possible refocus

Tackling so-called false self-employment is not new and in recent years the government has introduced and extended various pieces of tax legislation aimed at tackling what it perceives to be the effective incorrect classification of individuals as self-employed; for example, the intermediaries (IR35) legislation which is to be reformed from April 2017 in relation to its application to off-payroll working in the public sector and the rules on salaried LLP members introduced in 2014 (*see News brief "Taxing LLP members: a moveable feast", www.practicallaw.com/9-561-9285*).

On 2 March 2017, HMRC launched a new tool, the Employment Status Service (ESS), similar to the ESI, to determine whether assignments fall within the scope of IR35. The ESS asks 55 questions based on factors identified by case law and produces a result that can purportedly be relied on by the engager provided that the information has not been inputted fraudulently. There is no suggestion that the ESS will replace the ESI, since the latter deals with employment status in general whereas the ESS is intended to be an IR35-specific tool.

Similarly, the government is to extend the disguised remuneration rules from April 2017 to catch, among other things, so-called self-employed disguised remuneration schemes, thereby extending the disguised remuneration code in certain circumstances to those who are self-employed. The government has said that the purpose of the extension is to target certain contrived schemes that do not currently fall within the rules but have the same objective as those that do, namely to disguise remuneration or rewards for services, for example arrangements to secure an allowable deduction from the profits of a trade with that deduction, or the amount represented by it, being used to provide a loan or other benefit to a relevant individual.

However, the new legislation, contained in Chapter 3 of the draft Finance Bill 2017 is drafted broadly. It will,

Practical tips to ensure self-employed contractor status (continued)

- If possible, include an unfettered right for the individual to substitute someone else to perform the work.
- Try to avoid restrictions on the individual's ability to determine when and how he provides the services; for example, avoid a requirement for a certain minimum number of hours per week, avoid fixed hours of work, avoid undue supervision of the work by the company, and allow the individual where possible to determine when, how and where to provide the services.
- Avoid fixing the fees payable by reference to fixed hours of work and avoid fixed weekly or monthly retainer fees. Use a daily rate or, even better, a fixed fee for the particular job that is not tied to the number of hours it takes the individual to perform the job. If it is intended that the individual should receive additional fees for a successful project or a job well done, do not refer to these as bonuses, instead label them in a different way, for example, as success fees or additional fees.
- Do not provide holiday pay, sick pay or other employment benefits to the individual.
- Avoid taking steps that would suggest that the individual is integrated within the client company's business; for example, do not include him in internal telephone lists, do not give him a title which would suggest a permanent role with the client company, and do not invite the individual to company social events.
- Discourage the use of branded vehicles and uniforms; for example, Uber drivers are discouraged from displaying the Uber sign in their cars.

among other changes, introduce new sections 23A to 23D of the Income Tax (Trading and Other Income) Act 2005).

The government's fundamental attitude in this area is that tax and NICs should be determined by how work is performed, not by the legal structure through which an individual works, and it is clear that it will continue to examine whether this is achieved in the context of modern working arrangements as they develop.

A uniform definition?

The government has established a cross-government working group on employment status (the working group), chaired by the head of employment status at HMRC. The working group's remit is to consider the potential to move to a more uniform set of tests on employment status across tax, employment rights and the welfare and social security system. In particular, the working group has been examining the viability of an agreed single cross-government status test (and therefore single definition) and, if viable, the feasibility of a cross-government statutory employment status test.

The overall theme arising from the working group's meetings held throughout 2016 is that the government recognises that the concept of worker does not exist for tax purposes and that further work is needed before any conclusions can be reached. More broadly, the working group has been considering four possibilities to align the category of worker for employment rights and tax purposes:

- Abolishing worker status for employment rights purposes, with workers losing associated worker rights.
- Creating a new status of worker for tax purposes.
- Considering all workers to be employees for tax purposes.
- Considering all workers to be self-employed for tax purposes.

The working group is expected to make recommendations on next steps to ministers in early 2017.

Practical tips to ensure self-employed contractor status (continued)

- Be especially careful when entering into a contract for services with an individual who was previously an employee or worker of the company. If the services to be provided and the way in which they will be provided are not significantly different from the work the individual previously carried out as an employee, then there will be a risk of the relationship being determined to be a continuation of the employment relationship.
- Allow and encourage the consultant to carry out work for others and avoid exclusivity or exclusive service clauses.
- Avoid the use of post-termination restrictive covenants such as non-compete covenants.
- Ensure that the individual consultant provides at his cost his own administrative staff and equipment and bears his own expenses, for example, travel expenses, training, qualifications, visa applications, and the cost of insurance.
- Include an indemnity in the contract to be given by the individual in relation to income tax and employee's National Insurance contribution (NICs) liabilities, and penalties and interest in respect of the same, bearing in mind, however, that an employer cannot shift the liability for employer's NICs onto an individual.
- Consider engaging the individual through a limited company owned or controlled by the individual to take advantage of the benefits of IR35 (*see "A possible refocus" in the main text*).

Spring Budget

There had been speculation in the run up to the Spring Budget 2017 that the gig economy would be a key issue for the Chancellor, and as to whether new measures would be announced to tackle the tax challenges that it presents (*see News brief "Spring Budget 2017: key tax measures for businesses", this*

issue). In the event, however, no measures targeting the gig economy in particular were announced, and the key focus on employment tax was in relation to the changes announced, which were subsequently retracted, to more closely align the NICs treatment for the employed and self-employed. The Chancellor did, however, remark that he was looking forward to the outcome of the Taylor review in summer 2017 (*see below*). While the Taylor review explicitly excludes tax, this was perhaps a marker for possible changes ahead once the working group's recommendations have been made and considered, and the various other government initiatives considering the challenges of the gig economy are further progressed.

Government and Other Inquiries

A number of inquiries on working status have been launched, prompted no doubt by the recent employment tribunal decisions as well as the media reports and claims regarding the working practices of companies both inside and outside of the gig economy.

The future world of work

On 26 October 2016, the Business, Energy & Industrial Strategy Select Committee launched an inquiry into the future world of work, focusing on the rapidly changing nature of work, including the status and rights of agency workers, the self-employed and those working in the gig economy (*www.parliament.uk/business/committees/committees-a-z/commons-select/business-energy-industrialstrategy/news-parliament-2015/the-futureworld-of-work-and-rights-of-workerslaunch-16-17/*). As part of this investigation, the committee has said that it will consider the definition of worker, the balance of benefits between workers and employers, flexible contracts, zero-hour contracts, the role of the Low Pay Commission, minimum wage enforcement and the role of trade unions in providing representation.

Taylor review

On 30 November 2016, the government launched an independent review of employment practices, led by Matthew Taylor, Chief Executive of the Royal Society of Arts (the review) (*www.gov.uk/government/news/taylor-review-on-modernemployment-practices-launches*). Building on the employment status review (2015) report which was updated in December 2015, the review is intended to last six months with Mr Taylor's team taking evidence in public hearings across the UK between January and March 2017, and speaking to workers and employers working in sectors such as the gig and rural economies and manufacturing (*www.gov.uk/government/publications/employment-status-review-2015*).

The scope of the review appears to be wider than the government's future world of work inquiry. It will consider the implications of new models of working on the rights and responsibilities of workers, as well as on employer freedoms and obligations, and the results are intended to inform the government's industrial strategy. In parallel, the government has said that it will commission research into the scale of the gig economy.

Work and Pensions Committee inquiry

On 1 December 2016, the Work and Pensions Committee launched an inquiry to consider how the UK welfare system can support the increasing number of self-employed and gig economy workers (*www.parliament.uk/business/committees/committees-a-z/commons-select/work-andpensions-committee/news-parliament-2015/self-employment-gig-economy-launch-16-17/*).

Responses to the inquiries

To date, the only written responses to these inquiries that have been published are those that were submitted in response to the government's future world of work inquiry, although the number and variety of responses has been significant. Some interesting opinions arising from the responses include the following:

- Many have pointed out the benefits of the worker category. They argue that it accurately represents the way in which many individuals currently work and provides them with at least a certain minimum level of rights, even if they are not employees. It has also been pointed out that in some countries that do not have a worker status, such as the US, there have been calls for it to be introduced.

- If worker status is to be preserved, a new, clearer definition of worker should be created so that individuals are more likely to understand their status and their rights, and have less need to litigate to clarify their status.
- All categories (employee, worker and self-employed contractor) should be entitled to a unified set of discrimination and whistleblowing rights.
- Companies operating in the gig economy and possibly elsewhere should be allowed to offer certain benefits, for example, minimum hours and pay, to their contractors without this causing the contractors to be classed as workers, thereby removing any perception of unfairness. A variation on this theme is the suggestion that contractors could elect to opt out of a certain minimum level of rights and benefits in return for cash payments. This chimes with the request by Labour MP Frank Field, who chairs the House of Commons Work and Pensions Select Committee, for the introduction of a national standard of fair work in the gig economy, which would include an equivalent to the national minimum wage.
- More radically, it has been suggested that the categories of employee and worker could be merged, which would, in effect, extend full employment rights to all workers, although this could significantly increase labour costs for businesses.
- Others have questioned whether it would be beneficial to introduce a legal default position for employment status, as is the case in certain US states, where there is presumption of employment status unless an employer proves otherwise,effectively shifting the burden of proving employment status from the individual to the employer.

Areas for reform

It remains to be seen which, if any, of the various recommendations will be supported by the findings of the various inquiries and which, if any, will result in reforms. It is simply too early to say whether these inquiries and the recommendations that they may make will represent a threat to the gig economy's business model. We will also have to wait and see whether the recent tribunal and court decisions and others that are yet to be heard will, in some shape or form, force companies in this sector to make changes to their working practices, either to accept that their operatives are workers or to make changes to their working arrangements to bolster the argument for self-employment.

It will be interesting to see how companies in the gig economy will cope with the practical difficulties of calculating the national minimum wage and holiday pay for workers who source their work by logging onto multiple apps, assuming that the decisions establishing worker status continue to stand. Establishing legal certainty in this area quickly would clearly be beneficial and some have suggested that it should be made possible for appeals against employment tribunal decisions on these issues to be made directly to the Court of Appeal, thereby leapfrogging the Employment Appeal Tribunal.

Certain of these claims are still making their way through the employment tribunal system and have yet to be heard by the higher courts. It also remains to be seen whether the spotlight on worker status will be turned on other sectors of the UK economy where the use of large numbers of self-employed contractors has, at least up until now, been accepted practice.

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