Border control: Policing employment status

Throughout most countries of the EU ‘atypical employment relationships’ are gaining ground, with a working environment in which self-employment is challenging regular employment relationships in some industry sectors.

Status: common motives and concerns

The reasons are consistent and balanced throughout: flexibility and efficiency are desired on both sides (‘employer/principal’ and the ‘employee/contractor’), and the common wish to save tax and social security cannot be denied as a key motive. A downside for the contractor of course is a loss of labour law rights (e.g. minimum wage, annual paid leave entitlement, continuation of payments (in case of sickness or incapacity), working and resting time regulations, etc: except for those lucky enough to be UK ‘workers’. See the Introduction and other chapters in this publication.

Part of the reason why flexibility and tax concerns go together may be the demographic of those making up the independent workforce. A McKinsey Global Institute survey found casual workers, who may be combining work with study, retirement or other activity, are the largest section of the independent workforce. These may be people less concerned with the long-term benefits attached to tax and social security payments.

‘Casual earners’ are the largest segment of the independent workforce across all surveyed countries

![Casual earners chart](chart.png)

Whether a person qualifies as an employee or an independent contractor depends on specific circumstances. See *His masters’ voices*. The decisive criteria are similar across the EU and generally apply to the employment law as well as to the tax/social security law assessment of the relationship.

Surveys like this, and market commentary, consistently note that in addition to tax factors, autonomy, choice and flexibility are genuine motives for seeking non-employed roles. Legislators who want better, more sustainable work, must not ignore this. Yet neither can they overlook the state of public finances. It is estimated that in the UK alone the gig economy costs the government £4 billion a year in lost revenue contributions and benefit costs (source: Trade Union Congress, February 2017).

In the broader EU practice, which factors are more important and how to weigh the criteria differs significantly across areas of law and across borders. A common general rule is that the wording of the written agreement is not decisive. Performance and how arrangements are carried out in practice – i.e. real life – is to be considered. This ‘real life’ test poses issues for those who seek certainty in structuring relationships – it is not just a paper or online text.

The biggest risk of engaging an independent contractor is that competent authorities – in retrospect – determine that the relationship should be qualified as an employment relationship. If someone is wrongly classified, the employer may be required to pay income tax and social insurance contributions. The timeframe for mandatory back payments differs from country to country but can be three years or more. In addition, there may be other demands for late interest and penalty payments, administrative fines – even criminal charges.

These sanctions can be a disincentive to inward investors and senior managers who may be fixed with personal responsibility. In a different capacity, Uber executives in France have been subject to personal criminal proceedings. Talent thinks twice about disruption when the consequences can be traumatic.

If a worker in the Netherlands is found to have been wrongly classified, back payments of income tax and social security contributions for up to five years will be due. And the Dutch Tax and Customs Administration can also impose a fine up to 100% of the payroll taxes due from the employer. In Hungary, a tax fine amounting to double the evaded amount can be imposed, above the obligation to pay the initial taxes and social security (and interest). Administrative fines are also applicable, the amount depending on the number of violations, their duration and the number of workers affected. In Austria, back payments for five years (social security) and up to ten years (tax) apply. In certain circumstances, administrative fines and criminal charges might be imposed. In the Czech Republic exceptional sanctions apply to both parties but risk lies most with the engager. The principal may be fined up to EUR 370,000 and the contractor up to EUR 3,700. The Slovakian labour inspectorate can impose administrative fines on the principal/employer of EUR 2,000 to EUR 200,000.
“The UK’s tax system does not fully map onto its employment system – a person can be a ‘worker’ to have rights but remain self-employed for tax and social security. Levelling out this arbitrage will take some work, given how politicised taxation is in the UK.”

What am I?

Given these sanctions, many desire the certainty of official approval. In only some countries a facility for this exists.

There are no such approvals or checks available in Hungary, Slovakia and the Czech Republic.

In Poland, binding approvals are possible with regard to tax and social security. However, an application might encourage the authorities to conduct an audit to check if the authority recommendation is observed in practice.

In the Netherlands, there have been particular efforts from a tax angle to provide assurance on classification. Until May 2016 this could be done through the Declaration of Independent Contractor Status. These declarations were issued by the Dutch Tax and Customs Administration, based on forms filled out solely by the independent contractor. Having been handed the declaration, the principal was protected from withholding and paying payroll taxes. If, in retrospect, the declaration turned out to be wrongly issued, the consequences were borne by the contractor.

This system led to a surprising number of individuals being taxed as self-employed, at no risk to their (possible) employer. So the Dutch government designed a pre-approval system to make both the independent contractor and the principal responsible for an incorrect categorisation. As of May 1 2016, the Assessment of Employment Relationships (Deregulation) Act was implemented. To have certainty on the classification, the parties must use an agreement pre-approved by the Dutch Tax and Customs Administration. The parties can choose to either let the Dutch Tax and Customs Administration assess their individual contract, or engage on the basis of a pre-approved template. Since an employer in the Netherlands is liable to deduct and transfer payroll tax, they are the first party called upon by the Dutch Tax and Customs Administration, if performance of the agreement in practice differs.

In the UK, with a less strong culture of active officialdom, work is underway to use ‘RegTech’ solutions. The HMRC tax authority has launched an online status test to help consultants and principals see if their relationship enables them to meet it at arm’s length, or falls within IR35 tax rules.

Anonymous tests are permitted, and HMRC promises to apply the determination given by the tool – as long as the data input matches the actual facts.

But the UK’s tax system does not fully map onto its employment system – a person can be a ‘worker’ to have rights but remain self-employed for tax and social security. Levelling out this arbitrage will take some work, given how politicised taxation is in the UK.

As in the Netherlands, pre-assessment of the relationship exists in Germany, although the assessment takes place from a social security perspective. By answering questions on a form and submitting the proposed agreement, the parties can ask the authorities to label a relationship an employment agreement or a contract for services. In practice, however, this system is not considered to add much value as the factual performance is decisive, despite the assessment.
In Austria, the possibility to have a specific contractual relationship categorised by authorities is now under discussion. Currently (May 2017), only a non-binding request to the social insurance company is possible. However, a draft bill is due to be enacted as of 1 July 2017, according to the ambitious plan of the Austrian Federal Government. The aim is to provide legal certainty with a binding assessment of the social insurances, on condition that the provided information is correct and has not changed since the submission. In principle this is a welcome development for both employers/principals and employees/contractors in order to be safer with regard to the social insurance status. The draft bill is currently only in review phase, so changes still might occur, and the final version of the act and its application in practice will need to be assessed.

The Taylor Review has considered a broader use for such a tool to give status indications for the three UK relationships – employee, worker, self-employed. Noting that the common law system takes longer to adapt analysis to new technology and legal constructs, it looked at a form of “wise men” panel to issue guidance on interpretation.

This quest for certainty is fraught with difficulty, and could be argued to reduce the potential benefits of innovation: would Uber have carried so many passengers if it had been given an adverse determination on status three years ago? There are evolutionary arguments for the adversarial justice system. It permits different economic actors to make choices which help reach a balanced outcome and tests, issues and benefits which may otherwise go unseen if we rely on regulatory pre-approval.

Make me

One thing a disrupter has to weigh up is the risk of failure. The threat of a reclassification of relationships typically becomes acute in connection with tax and social security audits and gathering revenue is a strong motive for the authorities.

Since January 2016 it has been possible to submit agreements for approval by the Dutch Tax and Customs Administration. An initial evaluation in July 2016 shows that more than 92% of the assessed agreements are being rejected by the Dutch Tax and Customs Administration. Besides those alarming figures, there was also criticism of the system by both contractors and principals. Based on this dissatisfaction, the Dutch government decided to postpone the enforcement of the Assessment of Employment Relationships (Deregulation) Act until January 2018.

In Poland, authorities tend to concentrate on blue collar workers when it comes to reclassification of contractual relationships and leave white collar employees alone, unless in high profile sectors such as banking, IT or direct selling.

A consequence of reclassification (and sometimes its motive) is the applicability of mandatory labour law.
In our experience so far, reevaluations have only rarely been triggered by contractors, the majority of such proceedings arising in the course of authority audits as already mentioned. Situations in which the risk of enforcement by the contractor is significantly increased arise at the end of the contract as well as changed personal circumstances of the contractor like illness or parenthood.

This happened in the UK Pimlico Plumbers case, referred to in His masters’ voices and the Introduction, when self-employed Gary Smith had a heart attack and could not work minimum hours. Having been “let go”, he brought a case to establish worker status, with protection against disability discrimination. This reclassification could pose problems for him: he declared income as self-employed and in the last year of good health he declared trading expenses of £82,000 against income of £130,000. If he had to account for years of personal tax that could erode what he could win in compensation from the finding that, as a worker, he may have claims.

Alongside regulatory and judicial scepticism about non-status, enforcement of status claims by unions is becoming more and more common in the Netherlands, since a growing number of sectors such as healthcare, ICT providers, delivery services, and other platform providers are using or replacing employees with independent contractors. An example are a number of proceedings, with different outcomes, conducted by several groups of employees, supported by trade unions, against postal delivery companies in the Netherlands. As in the UK, these are signs of a revival of union activity in these previously marginalised workforces.

Developments: jeux avec frontières

The basic issues around the status of contractors/employees and their respective characteristics are quite similar in many European countries. But the underlying economic conditions and legal environments still differ considerably.

In the Netherlands, independent contractors and their principals do not fully know where they stand at May 2017, although we expect that the underlying idea of pre-approved agreements will largely survive the criticisms of the regime.

As regards Austria, the fate of the draft bill regarding the pre-assessment of status and the final wording remains to be seen: but we think the idea will be enacted as there is a need to give certainty and help businesses plan.

Elsewhere in the EU, these are signs of a common desire to balance rights with flexibility, and control an unregulated dive to the bottom of labour and tax costs. In Poland, contractors employed on a contract of mandate (a hybrid status between self-employed and employee) must be paid an hourly rate of at least PLN 13 (approximately EUR 3) gross since beginning of 2017 and they must report their working time on a monthly basis to the principal. The applicable rate is likely to be increased every year in January. In the Czech Republic, some changes are planned to the mechanism for paying social security by self-employed entrepreneurs, leading to a more transparent system.
In 2017, a tax-related initiative for small entrepreneurs (with an annual turnover of up to EUR 50,000) has been adopted in Slovakia, which makes the status of self-employed contractor even more interesting from a tax perspective, and presumably will lead to an increased number of service agreements driven by the contractors.

In Ukraine, there is a trend to tolerate questionable self-employment relationships given the tense economic situation; and legislation has been planned for years but has up to now not materialised. Under the current economic and political situation, a change in the near future is unlikely.

Hence the EU determining in 2016 a two year period for assessment of the issues around lost tax revenue versus job creation across member states. Current proposals suggest it will be 2020 or beyond before the EU looks to consolidate a more consistent approach to establish a European platform on ‘undeclared work’ – years in which non-member states may seek to gain advantage.

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