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STATUS CRITICAL

WHY EMPLOYMENT STATUS REFORM IS ESSENTIAL TO MAKING WORK PAY

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Fabian Research Report

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SUMMARY

Employment status is high stakes. An individual's employment status determines their rights and protections at work and the requirements which employers and engagers can make of their time. For employers, the legal status of their employees has a major effect on business models and business costs.

Yet identifying whether someone is an employee, 'worker' or self-employed is now a major challenge in the UK labour market. The UK is becoming a much better place to be an employee thanks to the Employment Rights Act and increases in the minimum wage. Yet these same positive steps – along with recent increases in and changes to national insurance – strengthen the incentive for some businesses to try and avoid an employment relationship. To do so, businesses may contract people as self-employed or as dependent contractors, technically known as 'limb (b)' workers. These problems are made more complex by the interaction between the UK's employment and tax status frameworks, which do not fully align.

This dynamic exposes and exploits longstanding employment status problems that the UK has been grappling with in recent years.

The employment status trade-off is currently being abused

In theory, each of the UK's employment statuses represents a trade-off:

- Employees tend to have to undertake work themselves, can be subjected to greater control, and can be expected to work (and to have work provided). They pay higher rates of national insurance but have more employment rights and income protections.
- A self-employment relationship lacks some, or all, of these characteristics, and comes with a greater degree of freedom, but without these parallel employment protections.
- People in the intermediate limb (b) status have a bit of both – a relationship that sits between that of an employee and self-employed person; the tax status of a self-employed person (usually); and only core employment rights, such as minimum wage and holiday pay.

In principle, then, different employment statuses balance different measures of risk, freedom and protection – and it is true that the vast majority of businesses do not need to be concerned about status because they engage their workforces appropriately. In reality, however, the situation is more complex for a significant group of workers.

Our research found three driving forces that undermine this theoretical trade-off in practice:

- **Strong tax and operational incentives to avoid engaging workers as employees.** Employer national insurance contributions (NICs) are not usually paid by companies that engage limb (b) or self-employed workers or by the individuals themselves. Companies that engage limb (b) workers provide fewer employment rights than they would for employees, and there are no employment rights obligations when engaging self-employed people.
- **Weak enforcement and lack of clarity in employment status**. Status is enforced ineffectively. Enforcement and clarity rely on some of the least powerful people in the labour market taking their case through tribunals – and sometimes to the supreme court. This is arguably made worse by the ill-defined and obscure 'intermediate' status of the limb (b) worker, which while intended to protect self-employed people, may be a 'get out' clause for some employers to avoid their responsibilities.
- **The wrong legal framework.** There are two issues with our framework. First, the UK has three statuses – employee status, limb (b) worker status and self-employment – which exacerbates the inherent problem of worker categorisation and means there can be, in effect, a 'lesser' form of worker. Second, the framework excludes from worker status many dependent self-employed people who need protection. Though it sits outside of the framework, there is a third, connected problem: self-employed people have no rights and protections at all, despite having higher rates of poverty than other workers.

These three driving forces combine to create three real-world problems:

- **'Bogus' self-employment and misclassification.** Bogus self-employment is when someone has the working relationship of either a limb (b) worker or employee but does not receive the benefits they are legally entitled to because they have been misclassified as "self-employed". For example, they may be subject to greater control than a self-employed person should be and yet not paid the minimum wage. This can be accidental, but it can also be a deliberate way for employers[i] to avoid their obligations. In some instances, this misclassification is done specifically through the use of 'sham' substitution clauses[ii] – ie a contract which tries to disqualify someone from being an employee by falsely indicating that they can send someone else to do their job. Adding complexity, some individuals in self-employment, including those who are misclassified and bogus self-employed, may also be paying tax as an employee, despite not receiving employee rights, due to HMRC's more active interventions around tax avoidance through rules like IR35 and "deemed employment". Misclassification is not unique to self-employment: many limb (b) workers are also misclassified. This "bogus limb (b)" working happens when the reality of someone's employment relationship means they should be entitled to full employee rights, but they are only given limb (b) protections.

- **Dependent self-employment**. This is when someone is *lawfully* classified as self-employed under current laws, but where the law should change to protect them because of the nature of their working relationship. For example, it might be that they are highly dependent on this work or are controlled excessively by the engager – meaning they do not have the genuine autonomy you would expect from legitimate self-employment. Some of those in "dependent self-employment" might be in this category specifically because they are disqualified from limb (b) worker status on the basis that they can and do send a substitute to complete work. This is "real" substitution which is actually undertaken. It is distinct from the problem of "sham" substitution described above, which is a mere contractual fiction.
- **Inadequate protections for limb (b) workers and the self-employed.** Limb (b) and self-employed workers currently have too few protections. Limb (b) workers do not have access to the full set of employment rights available to employees due to where they fall within the employment status and tax status frameworks: being in "limb (b)" locks them out of employee rights including protections against sudden loss of work. Being "self-employed" for tax purposes also excludes them from rights like statutory sick pay and parental pay which are currently tied to having "employee" tax status. Meanwhile, self-employed workers have very little employment and income protection of any kind, despite having significantly higher rates of poverty than other workers on average.[1] Ultimately, this intersection of the employment and tax status frameworks leaves

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[i] Throughout this report, we use the term "engager" to describe those businesses and employers who engage self-employed workers to perform labour for them / their organisation.
[ii] ESM0535 - Guide to determining status: is the right of substitution genuine - HMRC internal manual - GOV.UK

people outside of "employee" status with too few core protections, including around shocks to income in circumstances like illness, having a baby, or losing work.

Recommendations

The government must act to tackle these serious and growing problems. It has promised to move towards a single status of worker, merging "employee" and "limb (b)" categories, following consultation. We recommend they take urgent action this parliament to pave the way for longer-term structural reform, with a focus on improving the working conditions and security of the poorest and most precarious workers.

The government should:

1. The government should instruct the FWA to use its civil proceedings power to tackle misclassification of employment status. The government should take companies they suspect of systemic unlawful status misclassification to court and target their interventions to have maximum effect on sectors where misclassification is a major problem.
2. Introduce a presumption of dependent contractor (limb (b) worker) status whenever there is personal service and some element of direction or control. This would shift the burden of proof onto the engager and introduce an initial assessment of status long before any tribunal.
3. Introduce a presumption of employee status where control and integration are stronger. This would mean that if individuals could provide initial evidence of an employee relationship, an initial assessment of both their tax and employment status could be made.
4. Tackle the two substitution loopholes and extend limb (b) status to more self-employed people. The government can close the 'sham substitution loophole' by focusing on the reality of personal service for limb (b) status and close the 'real substitution loophole' by making personal service a relevant factor, rather than a necessary condition, of worker status.
5. Describe limb (b) workers more clearly in government guidance as 'dependent contractors'. This simple reform would help people understand more about their status and therefore help with enforcement.
6. Alongside the above recommendations, take a sector-by-sector approach to tackling status problems. The government and the FWA should focus attention where status problems are concentrated – such as takeaway food, final mile parcel delivery, construction and social care.

7. Require the FWA and HMRC to collaborate and eradicate zero-rights employment. Tax and employment status are inseparable and need to be tackled together strategically and operationally.
8. Review and reform employment status, tax status and entitlements together, acknowledging the central role of tax in shaping eligibility for statutory payments. The government must immediately improve protections for the self-employed and limb (b) workers. In the long term, an Employment and Tax Status Commission should set out fundamental reform of status, tax and statutory payments.

1. INTRODUCTION

The Employment Rights Act will shift the balance of power in the labour market, making employees' jobs more secure, providing more immediate access to sick pay when people fall ill and for workers who were previously excluded, and affording important rights from day one of employment.

This makes longstanding problems of employment *status* even more cause for concern, however. Whether someone is an employee, 'worker' or self-employed determines whether they qualify for these rights at all. There is now a stronger incentive for an employer to deny employment rights by exploiting the grey area between employment statuses and simply factoring in the low risk of (eventual) prosecution. This incentive is compounded by tax differences, heightened by recent changes to employer NICs, which further widen the gulf in labour costs between statuses.

Our current system of laws and enforcement cannot cope. We rely on our most vulnerable workers to bear the cost and stress of taking large corporations through successive court battles. For some of these businesses, fighting such legal battles simply becomes part of their business model.

This means less money in the pockets of poor workers who are not entitled to a minimum wage, holiday pay or sick pay. It means women denied full maternity pay and fathers without even two weeks off following the birth of their child. It means greater insecurity, with the risk of instant dismissal with no grounds or warning, and the massive income and status shock that results.

The government intends to consult on employment status, having previously proposed a 'single worker status' that would merge the intermediate limb (b) workers with employees.

This paper investigates the specific problems with employment status before setting out how the proposed solutions fix those problems. We draw on three focus groups with freelancers, gig economy workers and other self-employed people, two expert roundtables and a series of expert conversations.

The proposals set out in this paper are designed to help close the gap between employee and limb (b) status and tackle the most pressing issues facing workers now by taking practical steps within this parliament. If the government moves to a single status of worker, the steps we set out will be essential on the journey to wider reform. Regardless, these changes need to be made to tackle urgent problems of misclassification, problematic labour market incentives, and weak worker protections.

2. EMPLOYMENT STATUS, TAX, AND THE WIDER LABOUR MARKET

> "It's a balancing act, isn't it? Because it means yes, I will lose flexibility because I'd have to commit to a certain day or two a week, and that would probably have to remain the same, however the stability of having my tax paid for me by someone else, having holiday pay, sick pay, and some money in a pension plan, that's quite appealing, because I haven't had that for decades."
>
> Alan – self-employed focus group participant

Employment status is a complex but crucial subject. While it is of fundamental importance to all those in work, for the vast majority, it is often taken for granted. It is only for a smaller and often more precarious group of workers that employment status is a, obvious, visible determinant of day-to-day wellbeing.

In many cases, this is because such people they work on the 'margins' of status – in the grey areas between the three legal statuses of employee, limb (b) and self-employment. This section briefly sets out what we mean by employment status and how it relates to tax status. Finally, we set out some of the key labour market and policy challenges which intersect with status.

Employment status

In UK employment law, there are three main categories or "statuses" of worker: employee, limb (b) or "worker", and self-employed.[2] These categories and their definitions are set out in UK legislation.[3]

- Employee status garners the strongest protections, with full statutory rights, including protections against sudden loss of work through rights around redundancy and unfair dismissal.[4]

- Limb (b) or 'worker' status grants a lesser set of "core" protections, including the minimum wage, paid holiday leave and collective bargaining rights.iii [5]
- Self-employed workers do not receive employment rights, though they have some health and safety, discrimination and contract protections.[iv]

The boundaries between these statuses have been developed and clarified through case law. Legally, someone's employment status is determined based on the realities of their working relationship rather than how it might be described in a contract. Where employment status is unclear or contested, UK* courts apply several tests, developed through case law, to assess someone's status. These include:

- Personal service, or 'substitution': Is there an expectation that the individual always or often provides the work themselves, or could they substitute another worker in their place?
- Control: How much control and direction does an employer or engager exert over variables including when, where and how the work is completed?
- Mutuality of obligation: Is there a mutual expectation that paid work should be offered by the employer or engager, and accepted and performed by the worker?

Other tests may also be considered, including how 'integrated' an individual is within the workforce, how much risk the individual worker takes, and whether their tools and equipment are provided for them by the employer. Broadly, higher levels of employer control, an expectation of personal service, strong mutual obligation and the provision of tools by the employer have typically indicated 'employee' or 'worker' status depending on the level of control over and integration of the worker.

In recent years, the prominence of some of these tests in determining status has shifted through various case law decisions, while others have been increasingly subject to scrutiny – including the significance of personal service and substitution in determining employment status.[6,7] We explore these issues further in section 2.

[iii] The term 'worker' includes both employees and limb (b) workers, though it is often used to refer to only those who are limb (b)

[iv] If a person is self-employed, they have: protection of their health and safety; protection of their rights against discrimination (in some cases); the rights and responsibilities set out by the terms of the contract they have with their client

Tax and employment status

While employment status is front and centre in determining workers' protections, there is a second framework which plays a crucial role in their rights and entitlements: tax. Unlike the tripartite employment status described above, the UK tax status framework is bipartite: you are either an "employee" or "self-employed". The relationship between tax and employment rights has the following key features:

- **The two frameworks do not fully align.** Having "self-employed" *tax* status does not necessarily mean that you have self-employed *employment* status, for example. While 'employee' and 'self-employed' employment status broadly align with their respective tax status, limb (b) work is often treated as self-employed for tax purposes.
- **The tax system requires greater contributions from employers and their employees, and less of self-employed people and those that engage them.** Tax status shapes a number of tax obligations, the most significant of which are national insurance contributions (NICs). People with employee tax status pay 8 per cent of their monthly income in class 1 NICs, while those with self-employed tax status pay only 6 per cent through class 4 NICs. These differing tax obligations on the worker also trigger parallel tax obligations on the employer: where employees pay class 1 NICs, employers must pay their own class 1 NICs contributions of 15 per cent. Self-employed people can also claim a number of tax deductions.
- **Tax status rather than employment status triggers some 'employment rights' in practice, but inconsistently**. Statutory payments like maternity and paternity leave and statutory sick pay are linked to tax status, not employment status, for reasons linked to their origins in the old contributory system of national insurance. Parental leave entitlement is based on national insurance contribution and, broadly speaking, reimbursed by the government to employers. Statutory sick pay is also linked to national insurance contribution but is ultimately paid for by employers. The connections between tax and rights are inconsistent – as is the way in which tax "triggers" rights. Limb (b) workers tend not to qualify for these core in-work protections if they are classed as self-employed for tax purposes. Further inconsistency means there are also a small number of people who are employees in terms of their tax status but are not entitled to full employment rights.
- **National insurance no longer funds a truly contributory system**. Theoretically, national insurance would be paid by employers and employees into a government pot and then paid out in contributory benefits. In this system, self-employed people would pay less and

receive less in return. But, over time, the link between tax contribution and rights entitlements has been eroded: the national insurance 'pot' mostly just funds the state pension (97 per cent of total payouts), which now includes self-employed people. It is also now used to fund the NHS.

Wider labour market and policy challenges

There is also a wider set of problems and policy challenges in the labour market that interact with issues of employment status, even if they are not in themselves about status. First, there are some broader labour market challenges, including:

- The impact of technology. Technology is reshaping the labour market and employment relationships and, in some cases, being used as an efficient means to circumvent legal and tax obligations.[8] This use of technology is a major feature of the 'gig economy' – and there are indications this trend has proliferated into sectors such as retail.[9] As well as obfuscating traditional employment dynamics, new technology and decision-making algorithms also pose new challenges for workers through practices like 'dynamic pay'.[10]
- **Sector-specific challenges**. Status challenges exacerbate other problems in several low-paid sectors, including package delivery, food delivery, construction, social care and agriculture.[11]
- **Union and collective bargaining coverage**. Employment status issues are closely linked to statutory collective bargaining and trade union rights, which are available to employees and dependent contractors but not to the self-employed. In the high-profile employment status case of Deliveroo, for example, access to these statutory trade union rights were a key incentive for riders trying to achieve dependent contractor status.

Employment status issues interact closely with a number of government policies.

- **The employer NICs increase.** A number of changes to employer NICs came into force in April 2025, including an increase in the main rate from 13.8 per cent to 15 per cent and a reduction in the payment-triggering threshold from £9,100 to £5,000. This NICs rate is applied only when engaging people with 'employee' tax status. This risks increasing incentives for employers to use limb (b) and self-employed statuses, whether directly or indirectly via agencies or umbrella companies**.**
- **Minimum wage increases.** In April 2025 the government also expanded the national living wage to cover everyone over the age of

21 and made further increases to the rate to maintain its level at two-thirds of median wage.[12] They have also committed to converging the under-21s minimum wage rate with the national living wage.[13] While this is welcome, it does raise the costs of employee and limb (b) work relative to self-employment.

- **Employment rights improvements.** The Employment Rights Act 2025 (ERA) makes further welcome improvements to the floor of employment rights. But these strengthened rights also increase the cost of employing employees, and in some cases, engaging limb (b) workers. Without further reform, these changes risk incentivising limb (b), self-employment or agency models either for current staff or future recruitment. Some commentary has highlighted that the ERA might also disincentivise hiring groups which employers see as "higher risk", though the true impact is unclear.[14] Importantly, the improvements to workers' rights in the ERA simply bring the UK into line with the average for worker protections across the OECD.[15]
- **Zero-hours contract reform.** New reforms passed in the Employment Rights Act include the right to an employment contract offering guaranteed hours after a certain period, though many of the details are yet to be finalised in secondary regulation. This could have a range of interactions with employment status. Given that this policy affects mutuality of obligation, it is likely to have some interaction with status in practice – possibly meaning more people on zero-hours contracts are judged to be employees, all else being equal. In the event that Labour moved ahead with establishing a single status of worker, it is also possible that employers would turn to zero-hour contracts to try and retain the flexibility their business models rely on; though this may of course be tempered in turn by the stricter regulation of zero hours contracts through the ERA. There is also the possibility that zero-hours contract regulation shifts more employers to engage people in low autonomy self-employment (LASE), moving them outside of the protections of either limb (b) or single worker status – though this should, in theory, mean significant changes to how they operate.

3. STATUS PROBLEMS AND THEIR ROOT CAUSES

> "Just knowing how hard it was, you know, not being able to be financially. Stable, and like being really torn, wanting to spend time being present with my children, and taking that time to let my body recover as well, but at the same time it would have been great to have some kind of like 12 months or nine months of like pay that would have kept, kept me going."
>
> Janine – self-employed focus group participant

Employment status is high stakes, because it shapes the rights and protections of individuals and the requirements which employers and engagers can make of their time. It also has a major effect on employers' business models and business costs.

Because of this, issues with employment status have become a source of several problems. This section first discusses the problems as people experience them before analysing their root causes.

Three employment status problems

Problem 1: 'Bogus' self-employment and misclassification

Some people are being afforded only the rights of people who are self-employed despite having the employment relationships and dynamics of a "worker," whether an employee or limb (b), in practice.

A key issue here is that the 'engagers' of these people are not paying the fair 'price' for engaging a genuinely self-employed workforce. By unlawfully misclassifying these workers as "self-employed," they are retaining the accompanying tax and employment rights without sacrificing any control over their workforce. Sometimes, engagers will use contractual fictions that deter individuals from regarding themselves as workers. A prominent tool has been the use of 'sham' substitution clauses, whereby an engager will misleadingly write into a contract that someone can send a substitute while knowing that this will not occur in practice.

This misclassification is known as 'bogus' or 'false' self-employment and is unlawful under the current legal framework. Because it is poorly enforced in comparison to tax status issues, some of these individuals in bogus self-employment are paying tax as employees due to HMRC "deemed employment" regulations without receiving any employee protections – known as zero-rights employment.

This is a significant issue that needs to be urgently resolved. High-profile examples of bogus self-employment have included Uber and Bolt. In these cases, courts judged that their workers were falsely self-employed and moved individuals into limb (b) employment status.[16] More recently, drivers for Just Eat have mounted a similar legal claim to 'worker' status.[17] While the threshold for moving falsely self-employed people into employee status is higher than that for limb (b), it has also happened in some cases.[18]

The CIPD has previously estimated that up to 15 per cent of self-employed workers might be wrongly categorised.[19] The effect of being unlawfully denied rights is acute: being denied minimum wage protections, holiday pay, rights around collective bargaining, and the very basic protections of employment law. The scale of these problems in sectors like care and construction are well known – with widespread false self-employment and problems with enforcement.[20]

Misclassification is not only an issue for those wrongly classed as "self-employed". A secondary problem is the misclassification of people as "limb (b)", when they should be entitled to full employee rights – excluding them from core protections like sick pay and parental pay, as well as from protections against sudden loss of work through regulation around dismissal and redundancy.

Problem 2: Dependent or low-autonomy self-employment

Dependent or "low autonomy" self-employment occurs when engagers use the current legal framework to lawfully engage individuals as "self-employed", but in a way that we believe should grant them either limb (b) or full employment rights.

This might be because those individuals are dependent on that work, or because they are subject to greater control than is appropriate for self-employed status. It can also be because they are disqualified from limb (b) worker status because they can *and do* send a substitute, although the wider dynamics of their working relationship would otherwise categorise them as "workers" (as distinct from the 'sham' substitution above).

This is a significant issue, albeit one which affects a small section of the workforce. Workers in this group include Deliveroo riders, who are lawfully "self-employed" but who don't have control over key elements of their work such as price setting. That some Deliveroo riders did use their "practically unfettered" right to send a substitute in practice meant that courts judged Deliveroo riders to be self-employed, despite other indications that they were workers.

It is currently unclear how many people are currently classed as self-employed but who would be at least limb (b) workers if substitution was completely disregarded It is unlikely to be a large number, but the differential in rights and their vulnerability should make them a priority for policymakers. More generally, the capacity for sometimes-used substitution rights to act as a "loophole" for employers keen to categorise otherwise dependent workers as self-employed also requires attention.

Problem 3: Inadequate protections for limb (b) workers and the self-employed

Limb (b) workers do not have access to the full set of employment rights. Notably, they lack protection from unfair dismissal or redundancy. Self-employed people go without employment rights entirely, and have very little income protection, despite a higher poverty rate than other workers.[21]

Moreover, all workers with "self-employed" tax status – ie both self-employed and limb (b) workers – are excluded from key protections designed to support workers during income shocks like statutory sick pay and parental pay rights. Limb (b) workers, then, are 'dependent' as far as employment law is concerned, but are nevertheless excluded from core protections if they fall ill or have a new baby due to their tax status. Self-employed workers are at least meant to enjoy more freedom or autonomy. However, in practice, this is far from guaranteed – and they face a significantly higher risk of poverty.

The lack of protection for these two groups of workers is a significant problem. Previous analysis indicates that there are potentially 4 million limb (b) workers in the labour market.[22] That represents more workers than are employed in any single sector of the economy. Whether this group is best understood as closer to employee or self-employed status, their rights are far below that of employees and, with the introduction of the ERA and other policy changes, the gap is growing. There are more than 4 million self-employed people. Their poverty rate is higher than that of the wider workforce and they have almost no income protection.[23]

The root causes

1. Incentives toward precarity and a 'race to the bottom'

Both our tax and employment status frameworks make an employment relationship more costly than less secure forms of labour. The inevitable consequence of good employment rights and fair tax contributions is a powerful incentive for some organisations to engage limb (b) or self-employed workforces in order to avoid them. There are also increasingly powerful pressures on businesses trying to retain direct employment models against the 'tide' of tax and status policy and being undercut by others in the process.[24] We set out some of the key elements of these problems below.

Tax incentives against employee status

Employers who engage limb (b) or self-employed workforces currently see a significant tax advantage compared to those with employees because they typically do not need to pay class 1 employer NICs. The difference was made even more significant following the recent increase in employer NICs, which brought the rate up to 15 per cent. There is a similar incentive from the perspective of workers to categorise themselves as limb (b) or self-employed: people with self-employed tax status pay class 4 NICs at a rate of 6 per cent, while employees pay class 1 NICs at 8 per cent.

The different treatment of limb (b) and self-employed workers is loosely linked to their lack of entitlement to statutory payments – but, as set out in section 1, the link between tax status and statutory protections is now fairly weak.

This is an important root cause of all three of the problems identified earlier. It strongly incentivises bogus self-employment, dependent self-employment and unprotected limb (b) work.[25] Unless this 'race to the bottom' is resolved, enforcement action will face a strong headwind of tax incentives.

Potential solutions include:

- Immediate alignment of limb (b) status with employee status for tax purposes, as part of a broader alignment of our tax and status frameworks.[26]
- More gradual and tapered options for tax reform. Some have proposed an "engagers levy" set at a rate between 0 and the 15 percent employer NICs rate currently charged on employee labour. This would go some way to 'smoothing' the differences across different forms of labour and setting a proportionate tax on labour for those engagers who benefit from the advantages of a limb (b) workforce compared to one that is self-employed.
- Equalisation of taxes across all forms of labour – many experts have argued for this, but it introduces significant political and technical challenges.[27]

Rights and operational incentives against employee or limb (b) status

Beyond tax, organisations engaging limb (b) or self-employed workers have lower operational costs and frictions than employers because they do not need to guarantee the accompanying rights. The three statuses have very different costs and frictions:

- Self-employed people cost very little and generate little administrative burden. They have essentially no employment rights – only limited protections.
- Limb (b) workers are guaranteed the minimum wage, holiday pay, pension auto-enrolment, protection from deductions and various trade union rights.
- Employees have the full employment rights entitlement from statutory sick pay to parental leave – and now, all from day 1 (except protections from redundancy and unfair dismissal, which now begin after six months).

That there are less stringent requirements on engagers relative to employers is likely to be a significant factor in the three problems outlined above – bogus self-employment, dependent self-employment and inadequate protections for limb (b) workers. Many business models fundamentally rely on not having to make provision for these rights and outcompeting businesses that do. This is particularly acute in sectors that respond to fluctuating demand, such as parcel delivery, construction, or gig economy work. Differing costs and frictions are clearly the driving force on the boundary between self-employed and limb (b) status, which has been a deeply contested area. Companies have vigorously defended the self-employed status of their workers because anything else would come with minimum wage and holiday obligations – not because they risk paying higher tax, since limb (b) workers would likely not result in them paying employer NICs.

As in the tax system, there will always be an incentive to engage in these models. However, there are some options to improve the situation:

- Improving the rights of limb (b) workers. This would reduce the incentive to engage limb (b) workers compared to employees.
- Improving rights for self-employed workers (including pensions enrolment, statutory sick pay and parental rights) which would reduce the incentive toward engaging the self-employed compared to workers.

2. Weak enforcement and a lack of clarity

Poor enforcement and a lack of clarity are often cited as major factors in some of the above problems. Many have highlighted how unclear the boundaries are between employees and limb (b) workers; and between limb (b) workers and the self-employed. This lack of clarity, in combination with poor labour market enforcement, can lead to inadvertent or careless status violations. But they can also open the door to deliberate status violations – where employers unlawfully misclassify workers, relying on legal ambiguity, low probability of enforcement and low penalties. The fact that workers have to effectively enforce these rights themselves through the tribunal system, without sufficient support, is a further problem, exacerbating the power imbalance between workers and employers and increasing the likelihood of employers being able to get away with poor behaviour.

We find this to be the major driving force of problem 1 – bogus self-employment and misclassification. The complexity of the law is beyond what we should reasonably expect, as outlined by the Law Society and referenced in the Taylor Review.[28] The tribunal backlog is significant and rising, with an average time of 31 weeks between the initiation of a case and its conclusion – with many complex cases taking far longer.[29] If a tribunal finds against the engager or employer, the penalty incurred is usually simply paying the minimum wage and holiday pay which was due. This means there is very little deterrent against unlawful behaviour. A further problem also occurs when HMRC enforce the status boundaries with greater vigilance than the employment law enforcement agencies. In particular, HMRC policies are designed to prevent tax evasion through 'disguised employment' arrangements. This creates a phenomenon whereby individuals pay tax as employees and yet do not have employment rights – so-called zero-rights employment.

Several solutions are often proposed to these problems:

- Improved enforcement, with better resourced or focused enforcement through the Fair Work Agency and tribunals and higher penalties for violations (which would also improve clarity).[30]
- A presumption of worker or employee status. A "rebuttable presumption" would the legal onus back towards employers to prove they have properly categorised the people working for them.
- Improved clarity, with codification in law, clarifications to existing laws, or clearer advice. This would also help with enforcement.
- Aligned tax and employment rights, either through coordinated enforcement, better-aligned frameworks, or a requirement that 'tax triggers rights'.[31]
- Zero-hour contract reforms, which would prompt a conversation about the employment relationship and could help clarify status and inform tribunal judgments, particularly between limb (b) and employee status.

3. The wrong legal framework

Finally, some of the key problems of our status system raise questions about the framework itself. There are three different, though often interlinked, problems.

A two-tier workforce, with a weaker employee status

Many argue that our current framework creates a legal loophole which allows workers to be employed with weaker protections. First, it is important to acknowledge the intent of limb (b) status: it was explicitly intended to create a basic floor of protections for people who are not employees. It should have created two tiers of self-employment, with an enhanced self-employed status offering stronger protections for self-employed people. In other words, it should have been an extension of protections to a new group of people who would otherwise not be protected at all. Some, however, have argued that in creating a status between employee and self-employment, employment policy has in effect created two tiers of employees, with a weaker employee status for some workers.

The UK's formal tripartite model is rare, but in practice, other countries are often grappling with similar challenges. Evidence from countries with bipartite systems shows they still grapple with the divide between more dependent and more autonomous self-employment, and many offer stronger protections for self-employed workers who have lower autonomy and greater economic dependency than genuine entrepreneurs and freelancers. Italy has "lavoro etero-organizzato" – self-employed workers whose work is organised by the engager; Austria and Germany have an "employee-like" status; and Australia has "employee-like" platform workers. Others still have created protections designed to straddle statuses and focus on areas of the economy where status problems can intersect with wider precarity and disempowerment of workers. This includes the recent and significant EU Platform Work Directive, which sets a new floor of protections for workers in the platform economy across EU member states, including protections like a "rebuttable presumption," which assumes a more protected status for workers until proven otherwise.

We find that having the wrong legal framework also likely contributes to problem 3 – inadequate protections for limb (b) workers. By definition, limb (b) workers have less protection than employees, but if these individuals would otherwise be regarded as self-employed, then this would not be a problem. Further, limb (b) status is generally only recognised when self-employed people seek greater protections through the courts, so there is little evidence of limb (b) workers seeking employee status – which would be an indication of this problem. In practice, an intermediate status could both offer more protections for people who might otherwise be judged as genuinely self-employed, and less protection for people who might otherwise have had full employee status under a bipartite system. This is clearly a crucial question for employment status reform.

There are two potential solutions:

- Upgrading current limb (b) workers to full employee status (single worker status). This would make the 'pass mark' for limb (b) worker status the criteria for employee status in employment law. It would need to be followed by tax law reform to ensure at least some alignment lest it create a large group of untaxed employees with no statutory payment entitlements.
- Upgrading current limb (b) workers and a wider group of 'low autonomy' self-employed people to employee status. As well as limb (b) workers, there are some low-autonomy self-employed people who are currently legally self-employed who would also need to be protected. This would entail making the above change to the pass mark and further reforming the status tests to make personal service a relevant factor, rather than just a necessary condition, for worker status. Again, this would involve changes to tax law too.

Unclear and confusing statuses

Some view the three-part framework as too complex, suggesting that a two-part framework would bring greater clarity and simplicity. This is because establishing and enforcing two boundaries is arguably more challenging for workers, unions, companies, enforcement agencies and tribunals. Some argue that this lack of clarity produces a situation that can be deliberately exploited.

The contribution of the UK's three-part framework to the lack of clarity is unclear. Inevitably, having three statuses does introduce a degree of complexity, and in theory, it could be muddying the waters and contributing to the first problem – bogus self-employment – though not to the others. But as noted above, there are many problems in terms of clarity which are independent of the framework itself – and common in bipartite systems too. The labour market will always be complex at the margins of statuses, and it is unclear how much of a hindrance the existence of limb (b) actually is in reality (especially since awareness of limb (b) status is low). A shift to two statuses might introduce its own complexity, and would need to be tested through tribunals to provide even the limited clarity of the current system. Finally, as noted above, other countries have also faced these challenges despite bipartite frameworks.

The proposed solutions often include:

- Clarifying or labelling limb (b) workers more clearly to make it a more accessible concept – for example, as 'dependent contractors'.
- A single worker status which would remove the intermediate status completely, and with it any complexity that derived solely from its existence.

A 'worker' status that excludes self-employed people who need protection

The self-employed currently sit outside of the employment protections available to workers entirely. This is an issue that has attracted a great deal of recent attention. Most recognise that there is a group of 'genuinely' self-employed people: people who really are in business on their own account. However, there has always been a group of people who appear closer to worker or employee status – some who might be loosely referred to as 'freelancers', for example. These are people who would currently be lawfully self-employed, but may disqualified from worker or employee status wrongly – in principle if not in law. Often, this is because they are able to send a substitute and so fail the 'personal service' test, which has significant weight in determining status at tribunal.

We find this to be an acute and important root cause which enables problem 2 – dependent or low-autonomy self-employment. As noted above, many people are currently classed as self-employed but would be at least limb (b) workers if substitution was completely disregarded. (This is only for argument's sake, since personal service is likely to remain a relevant factor at tribunal following any changes.)

Proposals for tackling this problem include:

- Expanding limb (b) status to include a wider group of self-employed people by making 'personal service' a 'relevant factor', not a necessary condition, for worker status – thereby giving substitution less weight and including a new group of 'substitutable' self-employed people.
- Prioritising 'control' in determining status over personal service. This would be similar to the above proposal, but would foreground the level of control and autonomy in the relationship, thereby including a group of low autonomy self-employed people.

Summary

We find the three problems have overlapping causes and different levels of severity and scale. In table 1 below we have set out how the three problems and root causes interact.

	Problem 1: 'Bogus' self-employment and misclassification	**Problem 2: Dependent or low-autonomy self-employment**	**Problem 3: Inadequate protections for limb (b) workers and the self-employed**
1. Incentives toward precarity and a 'race to the bottom'	Lower NIC and weaker employment rights obligations incentivise bogus self-employment and bogus limb (b) work	Tax and employment rights incentivise dependent self-employment	Tax and employment rights incentivise misclassification as limb (b)
2. Weak enforcement and lack of clarity	Poor enforcement and ambiguity are a major cause and enabler of bogus self-employment and bogus limb (b) work		
3. The wrong legal framework	The tripartite framework may contribute to the lack of clarity that allows bogus self-employment to flourish	Worker status currently excludes a group of dependent self-employed people	Limb (b) workers don't have full employee rights

4. CONCLUSIONS AND RECOMMENDATIONS

Conclusions

Reforming employment status is increasingly important. Employment status guarantees people's rights and protections, and those protections are becoming more generous for employees, creating powerful incentives for a minority of companies to avoid their obligations. Allowing some employers to do so has the effect of undermining other employers that want to do the right thing and offer good, secure employment.

We find that there are three widespread and urgent problems that need to be addressed: bogus self-employment and misclassification; dependent or low-autonomy self-employment; and inadequate protections for limb (b) workers and the self-employed.

We find that there are three driving forces: incentives toward precarity and a 'race to the bottom'; weak enforcement and lack of clarity; and the wrong legal framework. We also find complex structural issues that need to be addressed together – the protections of self-employed and limb (b) workers, and the contribution system that funds these protections, need long-term reform.

Recommendations

The government should:

1. Instruct the FWA to use its civil proceedings power to tackle misclassification of employment status

The enforcement system relies on some of the most powerless individuals in the labour market to fight to establish their own employment status. With such a tribunal backlog and an imbalance of resources, it is unlikely that the companies abusing status will ever have to pay for it in the medium term. In turn, this means the potential cost can be written off as a relatively low probability in any business planning. But now, the FWA has the potential power to take up a case on behalf of an individual, shifting the balance of power significantly.

The government should instruct the FWA to use its civil proceedings power to tackle misclassification of employment status. . The agency should aim to have the maximum effect on the labour market by prioritising cases which exemplify wider behaviours, thereby sending a signal to a wider group of businesses. For example, it should pursue a substitution case in the gig economy – or prioritise status violations in large, high-risk, low-pay sectors such as final-mile parcel delivery and takeaway delivery. This is where the low risk of enforcement has often been priced in and where the precedent the FWA sets will have most effect.[v] While initially the FWA should focus on setting important precedents, it could also take up such cases as part of the process for presumption of worker status set out below.

2. Introduce a presumption of 'dependent contractor' (limb (b) worker) status whenever there is personal service and some element of direction or control[32,33]

It is currently an uphill battle for individuals to assert limb (b) status and with it their entitlement to a minimum wage, holiday pay and other important rights. The burden of proof is on the individual to argue their case at tribunal – and sometimes in the supreme court. A tribunal will always look at the reality of the working relationship to make its determination. But there are major obstacles in practice. First, it is very unlikely that an individual will make a claim in the first place, due to low awareness of complex status issues, perceptions of imbalance of power, and a low perceived chance of success. Second, it is unlikely to be successful even if they take up such a claim due to the imbalance of power: highly-paid legal teams will often be able to win against individual claimants without the resources to make it a fair contest. Often, the cases are settled out of court, which leaves the situation unchanged for the wider labour force. Recent cases that have reached the supreme court show just how long and arduous this journey can be. By contrast, in tax law, HMRC makes a tax determination which must then be challenged by the organisation through the courts. The National Minimum Wage Act also has a 'reversal of the burden of proof' clause when civil proceedings arise - and the enforcement of the national minimum wage involves issuing a 'notice of underpayment' at the start of any investigation.[34] Many other countries, some US states, and the EU have recently shifted toward presuming employee status in the first

[v] In practice, the FWA will take up cases of companies failing to pay minimum wage and holiday pay, which will require a tribunal to come to a status determination too.

instance and then allowing this status to be challenged by the employer/engager – establishing a so-called "rebuttable presumption".

The government should introduce presumption of dependent contractor (limb (b) worker) status whenever there is personal service and some element of direction or control. This would mean amending the Employment Rights Act 1996 with a 'reversal of the burden of proof' clause which could be very similar to that of the National Minimum Wage Act.[35] In practice, there would also need to be a process established in regulations, which could again be similar to national minimum wage enforcement.[36] First, an individual contesting their status (for example, because they are due unpaid minimum wage) should provide the FWA with limited basic evidence of personal service and an element of direction or control to initiate the process. This could also be done by a trade union on their behalf. It would only need to be very limited to minimise the burden on the individual (and because many jobs of this nature won't have extensive paperwork). If the evidence meets the criteria, the FWA should then require the engager/employer to provide a standard evidence pack to prove that an individual is not limb (b) – failing to do so would mean automatic classification as limb (b). The FWA would then open an investigation and make an initial assessment. Where appropriate, this would demand the recovery of minimum wage and holiday pay with an additional penalty. The 'early determination' could be overruled following investigation, and it could then be challenged by the organisation at tribunal. But at that tribunal, the burden of proof would be on the engager to prove that the individual was not a worker. If an individual wishes to skip the FWA's involvement, the presumption should still apply at tribunal.

The FWA should investigate wider status violations in any organisation found to have miscategorised workers. A status investigation should also be triggered by a national minimum wage underpayment investigation. In addition to repayment of national minimum wage and holiday pay, the penalty for status violation should be increased.

3. Introduce a presumption of employee status where control and integration are stronger

It is even more of an uphill battle for an individual to prove employee status – and with it, their entitlement to the full set of employment rights. Employee status naturally has a higher 'pass mark' than limb (b). This area could become more complex following reforms to zero-hours contracts which will require individuals to demonstrate regular hours and for an engager/employer to offer regular hours after a reference period. Both of these changes create 'mutuality of obligation,' which is considered when determining whether an individual is limb (b) or an employee.

The government should introduce a presumption of employee status where control and integration are stronger.[37] The process would be similar as presumption of limb (b) status and national minimum wage enforcement, but there would be some differences. First, an individual contesting their status should provide the FWA with basic evidence of employee status – which would include personal service and an element of direction or control, but also elements such as integration into the workforce and required availability. If this evidence meets the criteria, the FWA should then require the engager/employer to provide a standard evidence pack to prove that an individual is not an employee. Failure to do so would mean automatic employee classification. The FWA would open an investigation, make an initial assessment, and involve HMRC, since an employee for employment rights purposes is likely to be an employee for tax purposes too.[38] As noted above, strengthened penalties should be applied where appropriate.

4. Tackle the two substitution loopholes and extend limb (b) status to more self-employed people

Substitution has a major impact on whether someone is judged to be self-employed or a worker. If an individual can send someone to undertake a job in their place it weighs particularly strongly in the determination of a tribunal. There is good reason that substitution is often taken an indicator of self-employment, because it indicates that the individual need not themselves personally undertake the work, and personal service is one of the tests in statute and precedents in case law. And it would be hard to argue that an individual is a worker if they never undertook any work personally.[39] No doubt for these reasons, personal service features in most international definitions of employment status, including that of the ILO.

However, this gives rise to two distinct problems:

- **The 'sham substitution' loophole.** Many individuals are denied limb (b) status because, according to their contract, they can technically send a substitute to undertake their work. The test for personal service in the relevant legislation requires that an individual "undertakes to do or perform any work or services" for the other party. Despite the reference to "any", the statutory wording has left the door ajar for sham substitution clauses to defeat worker status because the word "undertakes" directs tribunals toward the contract rather than the working relationship in practice. Though interpretation of the law has already been shifting, as illustrated by the landmark cases Pimlico Plumbers v Smith [2018],[40] the continuing potential for substitution clauses to take individuals who look like workers outside of statutory protections is shown by the

'Deliveroo' case (R (IWGB) v CAC [2024]). At the very least, there is potential for employers to exploit the Deliveroo case and the uncertainty in the law by inserting substitution clauses in contracts.
- **The 'real substitution' loophole.** In addition to the above, many individuals are denied limb (b) status because they can *and actually do* send a substitute to undertake their work. This is distinct from the above situation where substitution is merely a 'sham' clause in a contract. The Deliveroo case mentioned above was an example of this – riders did have an 'unfettered right of substitution', which was genuinely used by some riders – so not, in fact, a 'sham', despite being written into contracts as the court case progressed. However, personal service has arguably been given more weight than is due in the determination of status in the courts: it has become a necessary condition for employee status rather than just a relevant factor. It is possible to send a substitute and still be a worker, if unable to work (James v Redcat (Brands) Ltd)[41] and the legal dividing line remains hazy. Many people have previously recommended making personal service a relevant factor, not a necessary condition, in tests of worker status, including the Taylor Review.

The government should tackle the two substitution loopholes. They should:

- Close the 'sham substitution loophole' by focusing on the reality of personal service for limb (b) status. They should amend the primary legislation above to focus more on the fact and less on the legal form, so that the definition reads "would perform, performs or performed personally any work or services" instead of "undertakes to do or perform".
- Close the 'real substitution loophole' by making personal service less decisive in judgments. They should amend legislation to make personal service a relevant factor, not a necessary condition, in tests of worker status. They should also set out the relevant factors at tribunal and the FWA should take them into account when determining status.

5. Describe limb (b) workers as 'dependent contractors'

The term 'worker' or limb (b) worker is itself a challenge. 'Worker' is a category which includes employees, while limb (b) is more precise but its language is obscure and technical. This contributes to the ambiguity of the status, particularly for those who are working in it, and people are less likely to enforce their own rights and status if they do not have a clear concept to reach for. Many have concluded that a new term is needed – including, most prominently, the Taylor Review, which recommended using the term 'dependent contractor'.

The government should describe limb (b) workers as dependent contractors. They should do so now in all guidance and communication (albeit with explanatory footnotes defining the precise legal term). They need not change the terms used in legislation immediately, but they should ultimately seek to do so, alongside further amendments below. They should support this with an information campaign targeted at high-risk sectors, working closely with trade unions.

6. In addition, take a sector-by-sector approach to tackling status problems where needed

There are sector-specific status challenges and concentrations of misclassification, in which additional sector-specific agreements could be made where they are genuinely needed. There are some sectors where the challenges are longstanding, such as in food, construction and package delivery. There are others where these problems are now just emerging due to new platforms and technologies, such as retail. Even the 'gig economy' itself contains many different sectors in which companies operate quite different business models. While the recommendations set out above are essential, the ability of 'sector blind' regulation to solve these problems fully is limited given how distinctive each area is. The Fair Work Agency, like its predecessors, focuses its activities on sectors where issues are most likely to be found. Other countries have often enforced status most effectively with a sector specific approach – the Riders Law in Spain or the EU Platform Work Directive, for example.

The government should take a sector-by-sector approach to tackling status problems. Some sectors require interventions above and beyond the economy-wide measures we propose. Initially, the government should convene unions and businesses across sectors regularly to discuss these challenges – alongside associated issues in the labour market. This should inform economy-wide legislation and regulation. In social care, the government should ensure that status considerations are addressed as part of the Fair Pay Agreement. The government should then consider rolling out fair pay agreements that address status problems in other priority sectors, which would require new legislation. It should prioritise the sectors where the poorest and most precarious are likely to be most severely affected. This would include, for example, food delivery, package delivery, construction and social care. They should define these sectors in the way which is most effective for improving working conditions.

7. Require the FWA and HMRC to collaborate and eradicate zero-rights employment

HMRC is a well-established enforcement agency whose actions have a major implication for employment rights. HMRC is set up for the purpose of ensuring people pay the tax that is due, and in order to do so, it must determine their tax status – which closely aligns with employment status. Moreover, new tax regulations have a major implication for business behaviour in the labour market, which in turn has a major impact on employment rights. Changes to tax policy have contributed a rise in people paying tax as an employee but not being afforded employment rights – so-called zero-rights employment. Finally, some rights are actually linked to tax status, not employment status – due to the relationship with national insurance contributions, as discussed above.

The government should require the FWA and HMRC to collaborate both strategically and operationally to eradicate zero-rights employment. Each organisation should be represented on the board of the other, and they should consult extensively on their respective strategies. The FWA should also be consulted extensively on any new tax regulations that could have an effect on employment status. And HMRC should be closely involved in any reforms to employment status. The two organisations should also pursue joint initiatives, potentially including taskforces targeted at parts of the labour market where both organisations' interest to overlap. And the government should investigate ways in which tax status can trigger employment status so that individuals are not left with the worst of both worlds.

8. Review and reform employment status, tax status and entitlements together

There are a number of fundamental and challenging issues that need to be addressed together, including those identified in the Taylor Review of good work, which has proved incredibly valuable. The government is right to review employment status before proceeding with any reforms, given how little is known about the individuals this would affect and how it would affect them. But there are strong reasons to look at employment protections in the round and to reform employment and tax status together:

- Self-employed protections are weak compared to other countries, and there is little justification for them to lack statutory payments.
- Limb (b) workers have important rights, but these are still far weaker than those of employees, and the ERA has increased the gap significantly.

- The contributory principle between national insurance and statutory payments is broken: the state pension accounts for 96 per cent of national insurance fund payouts, and self-employed people can now claim it, despite contributing significantly less via national insurance.
- Even with better enforcement, tax is a strong and increasing incentive either to misclassify workers or to lawfully operate with precarious business models.[42]
- A flexible but secure working arrangement is important for many individuals, especially those with family pressures and disabilities; this flexibility should be possible for all workers, including employees.

The government should review and reform employment status, tax status and entitlements together. They should:

- Commit to stronger protections and rights enhancements for limb (b) workers (dependent contractors) immediately, including prioritising introducing maternity and paternity rights and statutory sick pay equal to employees.
- Immediately improve income protections for self-employed workers, including a new paternity allowance, more generous maternity allowance, adoption leave, sick pay and pensions auto-enrolment.
- Set up an Employment and Tax Status Commission to review and reform employment status, tax status and entitlements together. The commission should include social partners alongside experts. They should investigate rights enhancements for dependent contractors, which could lead to an upgrade to employee status for both tax and employment – ie a "single worker status" – and aligning tax treatment and statutory payments across all statuses, ensuring everybody’s income is adequately protected after having children, when sick or unemployed, and in retirement, alongside fair rates of contribution.

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