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Skadden

UK Employment Flash

Insights into the latest employment news

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An Update on the Rollout of IR35

As a result of the COVID-19 pandemic, the introduction in the UK of changes to the IR35 tax regime for individual service providers has been delayed until April 2021. In anticipation of the delayed rollout, we revisit the rules and what private sector companies operating in the UK should be doing now to prepare for the new regime.

The tax rules, known as IR35, apply to individuals who provide services to a client through their own personal service company or partnership. In broad terms, under IR35, individuals engaged through a personal service company are taxed as direct employees (or directors) of their client. Currently, in the private sector, it is the responsibility of the personal service company or partnership to determine whether IR35 applies. As of 6 April 2021, this determination is the responsibility of the client.

If IR35 is deemed to apply, the client will need to deduct income tax and employee national insurance contributions from the fee that it pays to the personal service company or partnership. The client will also need to account for employer national insurance contributions, as it would for a direct employee. The employer national insurance contributions are paid directly to the UK tax authority, Her Majesty's Revenue and Customs (HMRC), in addition to the fee or remuneration paid to the worker.

When assessing whether the independent contractor would be considered an employee of the client, the client will need to apply the usual tax status test. This test considers a number of factors, including whether the contractor has the right to provide a substitute, the degree of control the contractor is subject to and how integrated the contractor is within the client's organisation. This test is not clear-cut, and no one factor determines the worker's tax (or employment) status. The test is highly fact-specific and should be applied on a case-by-case basis. As is currently the case, the tax status tests are (and will remain) different from methods for determining the employment status of the independent contractor for employment rights purposes.

Where there is a supply chain (for example, where the ultimate client engages an independent contractor through a number of subcontractors or intermediaries), the determination of IR35 status at one end of the chain may not find its way to the entity responsible for operating payroll. The new rules address this gap. If HMRC is unable to collect the tax and national insurance due, then the liability for that amount will pass along the supply chain until it is recovered. This approach could potentially lead to an entity being liable for uncollected tax and national insurance liabilities even if there is a long supply chain with multiple intermediaries between it and the relevant independent contractor, and even if that entity is not responsible for operating payroll.

What To Do To Prepare

While companies have been given an extended period to prepare for these changes, before April 2021 organisations engaging independent contractors should consider the following:

- Establish robust internal processes to regularly review the tax status of independent contractors engaged through a service company in order to assess the application of IR35 and deal with any subsequent disputes. Internal processes will need to be streamlined to ensure that a full IR35 assessment is carried out prior to engaging any independent contractors;
- Consider use of HMRC's CEST (the "Check Employment Status for Tax") tool that has been designed by HMRC to help organisations determine whether a worker is within the scope of IR35. While any finding by CEST is not determinative and there have been criticisms of the tool and its efficacy, it can as a minimum be a helpful starting point when carrying out an IR35 assessment;
- Discuss the changes with the recruitment agencies used by the organisation to understand what processes and procedures they have in place around IR35 assessments and declarations; and
- Budget for the additional employer's national insurance (and administrative) costs related to engaging independent contractors who fall within the IR35 regime.

Worker Rights: A Sea Change Ahead?

The debate on the correct status of workers in the gig economy is far from new. However, at the end of 2020, Just Eat announced it was taking a new approach to classification of its UK staff that could significantly change the worker status debate, as reinforced by a UK Supreme Court decision this month.

Typically, individuals working in the gig economy have been classified as independent contractors. In recent years, there has been much litigation in the UK that in many circumstances has determined that such individuals should be treated as "workers," as confirmed on 19 February 2021 when the UK Supreme Court determined that taxi drivers hailed through apps are workers while they are online and available for work. While not granting full employment rights, this gives individuals a variety of employment rights unavailable to the self-employed (such as the right to paid holiday, minimum wage and sick pay). In a significant departure from its previous practice, and potentially preempting worker status claims, the food delivery service Just Eat had already announced it would offer its couriers pay by the hour, rather than per job, and will also provide additional employment benefits such as pension contributions, holiday pay, sick pay and maternity or paternity pay. This goes some way to replicating the benefits that "workers" are entitled to.

While Just Eat already takes a similar approach in Europe, this is the first time it has operated this model in the UK. Just Eat said the move will mean its UK workers will earn at least the national minimum wage, ensuring the security of their income. The UK managing director of Just Eat said that the operating costs of the organisation would rise as a result but that, as a successful company, it felt this was the right thing to do. The UK Supreme Court's decision means that many other gig economy employers will need to take similar action.

Just Eat couriers have the option to opt out of the new hourly pay scheme and can continue to work as independent contractors if they prefer. Competitors of Just Eat, such as Deliveroo, have defended their existing working practices on the basis that their couriers and delivery drivers value the flexibility afforded by engagement as independent contractors.

Some campaigners have said that Just Eat's move does not go far enough. Workers will still be engaged through an agency, which some believe undermines Just Eat's pledges to improve worker status, and there are demands for Just Eat to engage couriers directly. The company will also reap benefits from the move. In addition to distancing itself from a debate that frequently smears competitors' names in the press and improving retention if workers are happy, Just Eat will be permitted to kit couriers out in Just Eat branded uniform, allowing them greater brand visibility than their competitors, who often limit this in an attempt to weaken any claim that their couriers and drivers are workers.

The Just Eat announcement is part of a broader focus on worker rights that will be important this year. Elsewhere, the UK government is currently seeking views on a specific proposal to extend the ban on exclusivity clauses in employment agreements. In 2015, exclusivity clauses (which prohibit employees from doing work under any other contract) were banned for employees on zero hour contracts. The government is now looking at extending that ban to contracts where the worker's guaranteed weekly income is less than the statutory lower earnings limit, currently £120 a week. This was initially considered but not pursued alongside zero hour contracts in 2014. The government is now revisiting that decision in response to the impact of the COVID-19 pandemic, which has meant that some employers are not in a position to offer all of their employees full working hours. The intention is to allow low-income workers who are not able to secure the number of hours they would like from their current employer to seek additional work elsewhere.

There is no doubt that the pandemic has sparked movement toward increased worker rights. It may also have had a heavy influence in Just Eat's decision, after a year where individuals in the gig economy — couriers and food delivery drivers in particular — have been viewed as essential workers. As challenging lockdowns continue, with the potential of a tough economic environment following, it is likely that this focus on worker rights will remain.

Considerations for Employers Requiring Staff To Get a COVID-19 Vaccine

As the focus shifts to a post-pandemic reality with the rollout of COVID-19 vaccines, we consider how UK employers should approach the requirement that their staff be vaccinated.

The ability to encourage the uptake of COVID-19 vaccines has proved to be a point of tension for UK employers balancing their health and safety obligations with some employees' reluctance to get the vaccine. While there are reports that certain employers intend to change their staff's terms and conditions of employment to require them to receive a vaccine, employers should carefully consider the potential pitfalls with this approach.

Employers usually require the consent of existing staff to amend their terms and conditions. Introducing a mandatory COVID-19 vaccine without employee consent (whether in the employee's contract or by other means, *e.g.*, a company policy or by including vaccine refusal as a ground for dismissal) may expose an employer to potential discrimination or unfair dismissal claims.

In relation to discrimination claims, while an employee's vaccine hesitancy or refusal will not on its own constitute a protected characteristic under the Equality Act 2010, employees opposed to receiving a COVID-19 vaccine on grounds of genuinely held religious beliefs or because they are particularly at risk due to existing health conditions are likely to be protected from detrimental treatment under the Equality Act 2010. Changing these employees' terms and conditions or dismissing them may constitute unfair treatment and could give rise to discrimination claims. Similarly, for employees with more than two years' service, requiring that they receive a COVID-19 vaccine or dismissing them if they don't may expose an employer to unfair dismissal claims. The employee may be able to put forward compelling reasons to demonstrate a dismissal on the grounds of refusing a COVID-19 vaccine is automatically unfair, including that mandatory vaccination interferes with their right to respect for private life under the European Convention on Human Rights and is neither government policy nor a legal requirement for their role, and that there are reasonable alternatives to dismissal available to their employer.

Similarly, for new and incoming staff, implementing mandatory vaccine requirements may give rise to discrimination claims and have broader public relations implications for employers. A possible exception to the above is in the health care industry or jobs where employees may be exposed to or provide care for clinically vulnerable groups. In those circumstances, an employer may have stronger grounds to require employees to be vaccinated or to dismiss employees if they can no longer fulfil the obligations required by their role and cannot be redeployed elsewhere in the business. In any case, a well-managed process involving close communication with staff should mitigate the risk of claims against the employer.

Some employers may be concerned that they will be exposed to claims for personal injury or failing to meet their health and safety obligations to other employees if not all their staff are vaccinated. On a practical level, given the transmissible nature of the virus, it would be difficult for an infected person to demonstrate they contracted COVID-19 due to close contact with the employer's staff or a breach of duty for which the employer is vicariously liable. Further, where an employer has conducted a workplace risk assessment, maintained robust health and safety protocols and followed government guidelines, it would be difficult for an infected person to make out their claim.

As employers prepare for a post-pandemic reality, the best approach is to continue to consult with employees on the return to the workplace, including vaccine uptake, and maintain health and safety practices in accordance with the latest government guidance. Employers should consider how they can best support and encourage employees to receive the vaccine (*e.g.*, being flexible with leaves of absence to receive the vaccine and organizing information sessions with employees). Where employees are hesitant to receive a COVID-19 vaccine when available, the employer should engage with the employee to understand the basis for this. Employers should also consider steps other than dismissal that can be taken to address any risk associated with employees who refuse a vaccine, including encouraging such employees to continue to work from home or reallocating their duties.

Consultation on Measures To Reform Post-Employment Non-Competes

The UK government has issued a consultation paper seeking views on proposals to require payment for post-employment non-competes or to ban them altogether.

The UK government is seeking views on its proposals for the reform of non-competes in employment agreements. It has looked to practices in other jurisdictions and proposes either to seek payment for the duration of a non-compete period or to ban provisions in employment agreements that prevent an employee from working for a competitor altogether. If implemented, such changes could see a shift in the ability of employers in the UK to restrict former employees who wish to join a competitor or start up a competitive business.

Whether the government's proposals would achieve the stated aim of encouraging innovation and creating jobs in the UK is unclear. In our experience, employers (particularly in the tech and financial services sectors) are keen to ensure that employees cannot damage their business if they leave, and the courts generally accept non-compete provisions as long as they genuinely protect the employer's legitimate business interests. Investors and purchasers of businesses are usually concerned if they have no ability to enforce non-competes against senior employees, and the lack of (or reduced) protection may affect their investing decisions.

The government's consultation is wide-ranging and looks first at the potential requirement that a company pay the restricted employee during the non-compete period as a condition of enforcement. This is already the case in a number of European jurisdictions such as Germany, Italy and France. There is some logic in requiring compensation if the employee would inevitably be unable to work while restrained by the non-compete, but that is not always the case and typically, in the UK, employers might expect to place employees on garden leave (for which they remain an employee and so are paid in full). Further, the government suggests that a payment requirement would act as a disincentive, so that employers seek non-competes only where they are really necessary. Questions remain around the amount that should be paid (with the government proposing between 60% and 100% of the employee's average earnings) and the ability for the parties to waive the non-compete period (or payment for it), whether unilaterally on the part of the employer or by agreement.

The consultation goes on to canvas views on banning non-competes in employment agreements altogether, which is the position in California and Israel.

There is a risk that imposing a universal ban on non-competes would be too blunt to address concerns about anticompetitive behavior in the UK. Each employment relationship is different, and businesses and sectors have varying requirements. This is reflected in current business practice — for example, it is more prevalent to see non-competes for a year or more are more common for underwriters who renew insurance contracts annually than for employees in sectors where the contract turnover is higher. English common law on non-competes has evolved over time to reflect prevalent public policy. The underlying case law provides a flexible and elegant solution to ensure that departing employees (and their new employers) do not gain an unfair competitive advantage at the expense of the former employer, through provisions that must be tailored to the requirements of their role and profession or industry. The law already ensures that a restriction cannot go further than is reasonably necessary in terms of scope, geography or duration to protect the employer's legitimate business interests, namely goodwill, customer or client connection, confidential information and workforce stability. The starting point is a presumption that the non-compete should not be enforceable and can apply only if the employer is able to demonstrate that it has a legitimate interest to protect. Each case is considered on its facts and subject to the individual circumstances of, and relationship between, the particular employee and employer.

Other post-employment restrictions (such as confidentiality, nonsolicitation or hire of employees, and nonsolicitation of or dealing with clients or customers) could fall within the new requirements if the definition of "non-compete" is not sufficiently precise. California bans any restriction that is tantamount to a noncompete clause. In the UK, a similar approach would lead to increased uncertainty and litigation unless there is a clear definition of the banned provision. Clarity would also be required to ensure that any ban does not encroach on separate restrictions in the context of business ownership, for example, and the application of any ban in the context of partnerships or other quasi-employment relationships would also need clear parameters.

The consultation paper considers other less drastic provisions, such as having a maximum non-compete period, a statutory requirement that the employee be required to take legal advice (or at least have the opportunity to do so) before a restriction can be binding and introducing a seniority threshold for employees who can be covered.

Further Institutional Investor Guidance for UK-Listed Companies on Impact of COVID-19 for Executive Compensation

Pay levels, reward structures and the widening gap between workforce and management pay have come under ever greater scrutiny in the UK. We have summarized the 2020 guidance given by The Investment Association, and recently by proxy advisory firms Glass Lewis and Institutional Shareholder Services, on approaches to compensation in the context of the COVID-19 pandemic.

The difficult trading environment caused by the pandemic, the short-term impact of support measures on which companies may have relied and the increasing focus on environmental, social and governance (ESG) issues have resulted in greater scrutiny than ever before of compensation arrangements. Investors and the public are looking closely at how companies are reflecting the pandemic's impact on their businesses and the wider workforce, as well as ESG concerns, in decisions about executive pay. In January 2021, the proxy advisory firms Glass Lewis and the Institutional Shareholder Services (ISS) published guidance specifically addressing approaches to executive remuneration in the context of the COVID-19 pandemic. This guidance follows the statements made by The Investment Association (IA) in April and November 2020 setting out shareholder expectations on executive compensation during the COVID-19 crisis.

The investor groups are united in their view that executive remuneration outcomes are expected to reflect the impact of the pandemic on businesses. The ISS states above-inflation pay raises or increases in variable pay opportunity are likely to be considered inappropriate without a compelling rationale. The IA states no bonus should be payable where a company has relied on government or shareholder support, with the ISS going further in stating that companies that had poor performance, cut workforce pay or required government, shareholder or other support, are generally expected to pay "little if no variable compensation to top executives." Glass Lewis takes a more moderate view, stating that where dividends have been cancelled or reduced, it would expect executive pay to be "somewhat affected." Where a company has made redundancies, furloughed employees or cut salaries, Glass Lewis has stated that how these measures were taken into account in determining variable pay outcomes and salary reviews should be set out in the remuneration report.

Adjustment of performance conditions for in-flight awards is considered inappropriate across the investor groups, with changes to targets for new awards considered reasonable provided the targets remain appropriately stretching. On grant size for new awards, the investor groups similarly caution against the potential for "windfall gains" as a result of a significantly reduced share price at the time of grant. Glass Lewis sets out the expectation that a reduction to grant size (or adjustment to other pay components) be considered where the share price at the time of grant gives potential for a "significant" windfall gain on vesting, envisaging a scenario where the share price has recovered by the time of vesting. The IA makes specific reference to use of discretion to ensure remuneration outcomes are commensurate with the shareholder experience and to ensure a good link between pay and performance, advising engagement with shareholders where appropriate. The guidance across the investor groups recommends thorough disclosure of the rationale for any adjustments or exercise of discretion in remuneration determinations.

For more on this topic, see our December 8, 2020, client alert, "Executive Compensation in the UK — Current Issues for Remuneration Committees and Considerations for the 2021 Voting Season," in which we consider the areas of concern for investors and the challenges for remuneration committees in 2021.

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