



The Freelancing Agenda

A Charter & Policy Proposals

Philip Ross and Andrew Burke
September 2014

**The Freelancing Agenda
A Charter and Policy Proposals**

by Philip Ross & Andrew Burke

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About Labour Finance & Industry Group

*Affiliated to the Labour Party:
Working Policy into Practice*

The **Labour Finance & Industry Group** (LFIG) works as the prime network for anyone interested in enterprise, finance, and business in the Labour party, providing a strong link between the Labour Party and the finance and business communities.

LFIG members range from business executives and established financial professionals, to graduate trainees and aspiring start-up entrepreneurs.

LFIG is an affiliated society to the Labour Party, not a lobbying group. It is our keen mission to engage the Labour party and business communities in ways to improve the enterprise ecosystem and create a thriving economy.

We hold meetings with many Labour MPs and frontbench members as well as hosting, co-hosting and sponsoring many fringe events throughout the year.

LFIG provides practical advice and effective support for Labour campaigns and Labour policy-making, as well as providing networking and social opportunities for our members and people interested in enterprise and finance.

A crucial feature of LFIG is our Policy Groups, comprised of expert practitioners in their particular policy fields. These Groups help to generate practical policy discussions, provide authoritative feedback, and act as a critical support force for the Labour Party and its policy making.

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Foreword

In March 2013, Labour's **Small Business Task Force** report, '*An Enterprising Nation*', made recommendations to the Labour Party for policies to help small businesses. The report looked in part at freelancing and self-employment, and suggested that '*greater clarity around the distinction between genuine freelancing and false self-employment is required to enable small businesses to use freelancers legitimately*'.¹

This report, commissioned by the Labour Finance and Industry Group, comes partly in response to that. It offers a set of principles, in the form of a Charter, and some specific policy recommendations, including a new definition of freelancing for tax and other purposes, that can help Labour to update its policies for this constituency, by enhancing, not compromising, the party's core values.

The image shows two handwritten signatures in black ink. The first signature on the left is 'Philip Ross' and the second signature on the right is 'Andrew Burke'. Both are written in a cursive, flowing style.

Philip Ross

Andrew Burke

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1. The freelance phenomenon

Over the last 20 years, more and more people have chosen to freelance. The workplace is changing faster than ever, and the constituency of freelance workers is growing in numbers across the nation, evidenced not least by the appearance of a plethora of new co-working hubs and offices. Freelancing crosses all industrial sectors, occupations and demographic groups, and is also apparent in Europe and the USA. In the USA there is now a freelancers' union with around 250,000 members. In Germany, a new freelancer movement has been established and this is being extended to other Europe countries. Alongside this, countries are adopting new legal frameworks for freelancers to work within.

People work as freelancers in many different ways.

- Some do multiple projects for clients at the same time. Others have one client at a time - some for one week, others for a year or more.
- Some are paid for fixed price work, others receive an hourly rate, some a daily rate. The rates that people receive vary enormously: some are paid £100s per hour others receive £10 or less.
- Some are operating through their own single person limited companies. Others may have banded together in a company, others will be registered as self-employed (Schedule D), while others will be operating through umbrella companies, which will do their tax and payroll.
- We also have people working in permanent jobs, and doing freelance work alongside to supplement their income, or to pursue a personal interest. They simply declare this extra income on their self-assessment self-employment tax returns.

Some freelancers find work by advertising, others through referrals and others source work through recruitment agencies. Though some agencies just place permanent staff and temporary staff, others, particularly in the IT sector, just focus on sourcing freelancers for contract work.

The number of those working freelance in the economy is growing year on year. Freelancers work in all business areas and use a variety of skills, from the media and film, journalism, music, to IT, to construction projects and engineering, and of course acting. There are both push and pull forces in place where some freelancers have embraced the model as it is the only way to find work, for some it is a true lifestyle choice as it is embraced for the flexibility that it offers, while for others it is because they have the confidence to go it alone and capitalise on their skills and experience.

2 The freelance economy

2.1 A definition of freelancers

There is no legal definition of what a freelancer is; indeed it is often a self-descriptive term. Some may talk of themselves as being contractors, others as self-employed, and others as freelancers. All are a subset of the wider self-employed population of 4.54 million. Often these terms are industry or market specific. They are all part of the flexible workforce. It is worth being clear what we mean by 'freelancers'. The Oxford English Dictionary defines a freelancer as a "person working for no fixed employer". Wikipedia defines a freelancer as "somebody who is self-employed and not committed to a particular employer long term". Neither of these gets to the heart of the issue.

Essentially, freelance workers hire out their labour services on a project-by-project or limited duration basis, for remuneration which is output-focused. Freelancers are therefore usually paid on the basis of their output, rather than the more commonly used approach in continuous employment where workers are paid on a time-input basis (e.g. weekly wage or monthly salary). Freelancers also take on all or most of the costs and risks of their own labour downtime, and of below-expectations productivity within projects. They also take on all the cost and risk of economic inactivity between projects.

In varying degrees, freelancers compete for work with other freelancers (sometimes overseas), employees, and businesses. Hence their ability to compete requires an ability to remain competitive across a diverse set of characteristics. For example, UK based freelancers competing against overseas freelancers must sustain international differences in income tax rates. Similarly, freelancers competing against larger limited companies need to be viewed as a comparable business entity in order to be viewed as legitimate by customers.

Some freelancers may be working with the tax status of a self-employed individual, others through limited liability companies because they source their work primarily through agencies. Some skilled freelancers can enjoy high rates of pay and little have interest in 'freelancer rights', while there is a category of lower paid freelancers – or precariat freelancers – who are seeking some rights at work, or at least the right to be treated fairly and not to be exploited.

2.2 The extent of freelancing

Freelancers represent a significant and growing proportion of the UK labour force. In 2013, research from Kingston University based on ONS data estimated that 1.77 million people were freelancers constituting approximately 6% of the UK workforceⁱⁱ. The same research estimates that since 1992 freelancing has grown by just over 70% from 1.04 to 1.77 million workers. Other research carried out by Cranfield and Exeter universities based on an independent survey of firms in 2013 indicates an even greater scale of freelancer use by British business accounting for 17% of their full time equivalent workⁱⁱⁱ.

Freelancers are particularly significant in certain occupations. In 2012 Kingston University research^{iv} showed that freelance workers are particularly important in:

- Associate professional and technical occupations, including writers, artists and musicians, accounted for 630,000 freelance workers (40 per cent of the freelance workforce). Of this, 256,000 work in artistic, literary and media occupations.
- 576,000 freelance workers (37 per cent) were in professional occupations
- A further 352,000 (33 per cent) work in managerial occupations

The 2012 Kingston University study also suggests that while freelancers are present in all industries, they are most commonly found in 'Professional and Scientific activities', 'Education', 'Arts, entertainment and recreation' and 'Information and communication' industries. They say that more than half the entire UK freelance workforce is working in these four industries, and that one in five workers in 'Arts, entertainment and recreation' are freelance, and one in seven in the 'Information and communication' sector. Cranfield University research suggests that in homebuilding in the construction industry this can rise to as high as 50%.^v

In terms of demographics, the evidence is that more than 60% of freelancers are male. The 2012 Kingston report notes that this is a larger proportion than among employees in comparable occupations. It notes that there were 210,000 working mothers (25% of all freelancers), and that this constituency had increased by 25% since 2008. It also noted that 20% of freelancers were aged 60 or older^{vi}.

All this echoes what the press are regularly reporting - that the self-employed and freelance market is growing. In research conducted by think tank Royal Society for the encouragement of Arts, Manufactures and Commerce (RSA),

and e-commerce firm Etsy, concluded that the number of people working for themselves will rise above those working for the government as soon as 2018.

In the first of a series of reports the RSA predicts that 5m people will be self-employed in 2018, and the public sector workforce will fall to 4.9m. RSA's Benedict Delloit said, "Micro-businesses are the new political force to be reckoned with, but the government has yet to win their favour"^{vii}.

These numbers are significant, and our conclusion is the same as that of the RSA - that the freelance economy is growing and is going to form a significant part of the UK economy, and is developing its own policy agenda.

What these figures are demonstrating is that freelancing is forming a significant part of the UK workforce and is not limited to single industries, but is significantly across the economic landscape.

2.3 Economic benefits of freelancing

However, freelancers are important not only – and perhaps not mainly – in terms of absolute numbers, but in other ways as well.

There is strong evidence that freelancers play a pivotal role in Britain's 21st century innovation-driven economy.^{viii} They are sources of, and conduits for, innovation in both corporations and SMEs. As the UK economy has become more innovation driven and dynamic, it has increasingly needed to be able to draw on freelancers who generate economic growth and prosperity.

The benefits that freelancers bring are:

- Liberate businesses from the limits of their internal resource bases, and enable the use of exceptional talent that would otherwise not be economically feasible to hire on employee contracts
- Enable de-risking of some of the uncertainties of the market so that firms can reduce the risk of growing
- Reduce the amount of finance required for innovation and business start-ups
- Promote efficiency-driven, economic performance
- Reduce barriers to market entry and reduce minimum efficient scale
- Enable businesses to maximise performance across peaks and troughs in demand
- Create jobs by increasing the level of innovation and efficiency in the economy and helping new projects succeed
- Enable businesses to manage, in fact reduce, entrepreneurial risk and so promote innovation and enterprise

These economic forces have caused the composition of freelance workers to evolve from being mainly dominated by a low-paid shadow freelance workforce, to a high-paid, dynamic body of freelancer professionals. This latter group distinguish themselves by typically working on a project basis and being remunerated on an output, rather than an input basis so typical of employees. These dynamic freelancer professionals are entrepreneurial; working on a self-employed basis and taking on the risk and cost of downtime, both within and between projects. They enable innovation driven businesses to tap into diverse talent on a variable cost 'pay as you go' basis, which makes these businesses agile, flexible, innovative, and internationally competitive.

Many of these dynamic freelancer professionals must compete for projects on an international basis against freelancers who operate in other countries. Therefore, being able to be cost-competitive, talented, skilled, and legitimate, are key drivers of the international performance of UK based dynamic freelancers.

The recent Recruitment and Employment Confederation (REC) report on flexible working included many testimonies from firms on why they believe that freelancers\contractors are so important:^{ix}

'On the product development side, we often bring in highly skilled contractors on a project basis where the headcount increase will be funded by the project budget. We pay a premium for those skills, but the contractor market is often the only place you can source them.' **Jaguar Land Rover**

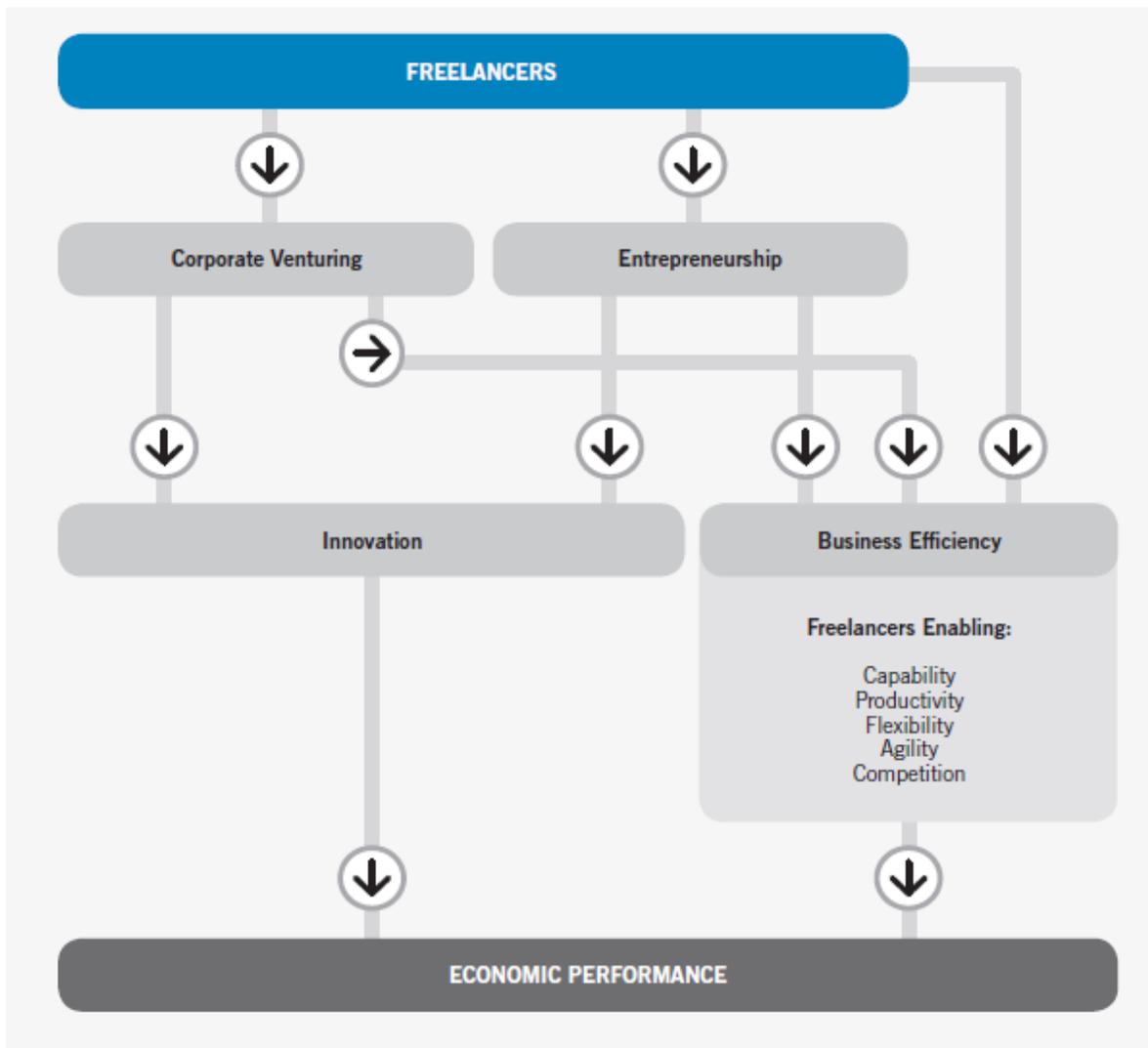
"We are very project driven and assemble teams with specific skill sets to deliver the projects. It is about bringing the right people for a set period of time. We can get very good talent quickly, easily and cost-effectively through the contractor market" **David Bullimore NSG Group**

'We use a range of approaches to flexibility across our territories. In Germany, most of the staff are on full-time contracts, and the only flexibility comes in the form of additional freelancers at peaks in demand. Belgium, by way of contrast, is very much run on a project-by-project basis – skilled individuals are brought together as needed to deliver.' **Liz Love, Z-Card**

I couldn't afford the talent I wanted, but I had identified that the level of person I needed often had a young family. So I started offering senior designers part-time hours and other flexible arrangements that fit with their other commitments in a bid to attract them. The experiment was a resounding success. It's all about competition. The driver is making your own business better. We want to retain people, and we get contractors in when we need to access talent that we cannot afford on a full-time basis.' **Ann Rimmer, Director of Strategy, Clock Creative**

'We use limited company contractors when there is a client need for short-term demand. These individuals do not want to be permanent, but we like to use the same contractors over time if they are good.' **Leanne Byrne, Amec**

The total effect of freelancers on economic performance is then a combination of the corporate venturing and entrepreneurship effects, working to promote innovation-driven economic performance, combined with enhanced efficiency-driven economic performance promoted by the input of freelancers. The total effect of freelancers on economic performance is depicted in the figure below. It underscores the importance of freelancers to the British economy. Essentially, freelancers enable businesses to do things they could not otherwise do, and hence they have become key drivers for economic performance in the economy.^x



3 Issues for freelancers

3.1 Lack of recognition

Although freelancers make a distinctive contribution to the economy, there is a common lack of recognition of that contribution, and a suspicion that the rise of freelancing is an undesirable development. Indeed, freelancers are sometimes portrayed either as people who have been coerced into self-employment, or as people hiding behind a freelancing shell to avoid paying higher and additional taxes, as well as national insurance.

In addition, when the role of freelancers is recognized, it is often misunderstood. Freelancers generate the benefits discussed in the previous section, not as replacements for existing employees, but predominantly through working partnerships with those employees. This symbiotic relationship between employees and freelancers has, however, often been overshadowed by perceptions of their competitive interaction. This common view that freelancers are just a shadow workforce for employees is a misconception. Freelancers mainly serve a different economic function – particularly in driving innovation and helping firms overcome the challenges faced by risk and uncertainty – and in doing so they help create and sustain employment.

There is very little research on freelancers in this modern economy context. The main reason for this is that their new pivotal role has only really come to the fore with the emergence of the innovation-driven economy. This lack of understanding and of definition has real consequences, since those who choose to become freelancers can encounter unnecessary risks, (particularly in relation to fiscal matters), as well as barriers to trade, as a result of their requirements not being recognized and addressed.

3.2 Concerns of businesses

Firms who engage freelancers do not consider themselves to be hiring temporary employees, but to be engaging a supplier and to be filling a skills gap. Some firms are comfortable engaging self-employed freelancers, in effect treating them as ‘workers’^{xi}. For work that isn’t done on the client premises or is of short duration, this isn’t an issue. However, larger firms are not comfortable with this risk, especially if the freelancer they are engaging is on a high fee rate. They will usually insist that the freelancer operates through a limited company – just like their other suppliers.

This is also true if they are recruited through an agency. The concerns that firms have, even if they are using an agency, is that they will expose themselves to both tax and employment risks. Namely, that they can be liable for unpaid taxes by the freelancers, and the risk that the freelancer can acquire employment rights with them. This is an important issue because it has influenced the market and encouraged the use of limited liability companies by individuals as opposed to them being self-employed.

Thus, the resulting operating model and contract terms in the freelance economy are geared towards mitigating these risks from the perspective of the client. Many of these risks are unfounded, but because freelancing is in the shadows there is a large amount of ‘fear, uncertainty, and doubt’ that shapes this.

Non-agency freelancers: In industries where there has been a large concentration of freelancers, but where the agency model is not present, many freelancers have continued to operate as self-employed without the need to resort to using limited liability companies. This is the case for musicians, film and television crews as much as it is for actors. These groups are strongly represented by established trade unions. This organised representation has meant there are good industry standards reflected in good terms and conditions for their members. These markets have evolved such that some have contracts which give their members ‘worker’ status backed up in many cases by collectively bargained agreements. The key element to their members is the ability to offset travel expenses and equipment purchases against tax. In other sectors where representation is weaker, there are no standard contracts and there are much weaker terms and conditions for freelancers. There is a good case here for creating a better market in part through enabling better representation and organisation for freelancers. At the same time, the value added provided by freelancers is based on the ability to hire them on a flexible and agile basis, so it is important that these core features are preserved in any move to create industry wide standards or representation.

What is needed is help to nurture the symbiotic relationship between clients and freelancers.

- To make it easy for clients to engage freelancers
- Ensure that contract terms are fair and at least consistent with a living wage

3.3 Need for a clear definition of freelancing

We believe that there is a resultant need for a clear definition of freelancing, and recognition of freelancers’ positive economic contribution. This would benefit both freelancers and those who use them. This would enable public policy – particularly in relation to fiscal matters, industry, enterprise and the labour market – to help rather than hinder those who choose to freelance and those who engage them.

The freelance market as noted may be wide and deep in varying places, but all are united in the fact that as individuals in business, they have no fixed employer or client.

The important and distinct economic role of freelancers in the modern economy needs to be:

RECOGNISED: Defined as unique economic agents providing an important and distinct economic function to employees and business owners.

PROTECTED: The unique economic value-added provided by freelancers is part of the core of the modern British economy and hence needs to be allowed to thrive.

NURTURED: It is good policy to ensure that British business always has access to a sufficient supply of high quality freelancers in order to optimise the potential of these businesses.

3.4 What freelancers told us

Our research and discussions with a variety of groups suggests that recognition of freelancing is needed to enable a number of issues to be addressed.^{xiii} These include:

- The right to be issued a contract and the right to be paid, and paid on time. (This came up time and time again with many of the groups we spoke to. Often those on the lowest wages have the weakest contracts and find it the hardest to be paid. It is as if they are not taken seriously as suppliers).
- The ability to move from welfare to freelance and back again without undue difficulty. This is of a greater concern to precariat freelancers. This also comes down to the right to opt in and out of Social Welfare. Concerns raised to use over the new Universal Credit proposals are that they could force people out of the more creative professions and into other employment.
- Also for all freelancers, whether workers or professionals, there are issues around the accrued benefits of employment which need to be shared with freelancers. The most telling is maternity and paternity leave where there is a perceived unfairness. There should be a system in place that at least allows freelancers to offset tax payments against maternity pay and back date this over a number of years.
- Status issues for both tax and employment purposes. At present the limited company liability model offers lots of assurance to clients that they will not be liable for taxes. Freelancers themselves are not always sure of their tax status and their status for employment and tax can be judged differently.
- That the freelancers are in business on their own account. (Particularly true for freelance professionals).
- Concerns about paying taxes in advance and the ability to pay them more regularly.
- Problems with the use of Limited Liability Companies
Freelancers feel that the IR35 rules used by HMRC to determine the tax status of limited company freelancers are not fit for purpose. ^{xiii} HMRC feel that those using limited companies need to pay their fair share of tax. (This is discussed in the next section)
- The ability to assert 'rights at work', for instance health and safety issues, bullying, and discrimination. It is acknowledged that these rights do exist, but there is a need for them to be asserted more. This was less of a concern to freelance professionals.
- The need to balance the need for individual freelancer rights, and rights for freelancers to be recognised as a business. There are two sets of rights that are being asserted by freelance community. 'Freelance workers' especially precariat freelancers are anxious to assert their 'rights at work'. This tends to be in sectors where the labour force is largely freelance in nature and where there isn't a standard contract in place (or any contract in place).
- Support for professional freelancers who seek the right to be recognised as a competing business rather than as an individual. In this market they are competing as independents against large businesses and want to be engaged on similar business terms rather than employment terms. They do not wish to acquire worker or employment rights.
- Concerns about forced self-employment.
That some self-employed workers believe that their work does not fit the definition of freelancing defined (in section 2.1.) above and hence should be classified as temporary workers.
- Umbrella companies have an important role to play in helping some freelancers enter the market, and that both blue and white collar workers can be legitimately engaged through umbrella firms.

3.5 Freelancers who use a limited liability company

We have included this section to explain in more details the issues around why freelancers use limited liability companies and issues that this throws up.

The benefits that freelancing delivers to the economy were laid out in the previous section and are quite compelling, however, criticism around freelancing isn't on the benefits that it brings to the economy – though this isn't recognized – but around the benefits that it brings to the individual.

It begins with the whole argument around the tax differentials between employment and self-employment, but for freelancers continues on to look at the same differential between being self-employed and the use of a limited liability company by that individual. Anecdotal evidence from the groups show, however, that the majority chose freelancing for either economic reasons (rates of pay were significantly higher), personal or lifestyle reasons, or through market pressure (only way to get work), few sited tax as a driver^{xiv}. Such an axiom is correct and needs to be maintained and bolstered that people freelance not for tax reasons. If the reasons why firms choose to engage people as freelancers rather than as employees is because of tax savings on their side then it can be an issue.

The criticisms around freelancing are often around tax, and the tax models used by freelancers and the use of limited liability companies by freelancers is the one that often attracts the most criticism.

3.5.1 Why do agencies insist that freelancers use a limited liability company?

The reason why agencies wish for freelancers to use limited liability companies is that unless they do so they will be treated as temporary employees of the agency (as “agency workers”). As agency workers they would be paid through the payroll and would acquire agency worker rights.

However, freelancers who want to invoice and not acquire such rights – because they are operating as businesses, need to be differentiated from temporary workers. Such differentiation based around the presence of a limited liability company has been in legislation since the mid-1970s.

- 1975 when clauses were present in Section 38 of the Finance (No.2) Act.
- 1978 in the Social Security (Categorisation of Earners) Regulations for National Insurance.
- 1988 in Section 134 of the Income and Corporation Tax Act (ICTA)
- 2003 in Section 44 of ITEPA 2003.
- Subsequent implementation of EU directives on agency workers also draws on Section 44.

The industry short hand for these regulations is of ‘Section 44’, which we also use in this document.

The motivation behind the regulations has been to protect temporary workers and stop them being forced into self-employment. It was felt that a good differential between temporary workers and freelancers would be if freelancers operated through a limited liability company. As limited liability companies weren't that easy to set up.

This also means that small firms can find work through agencies too.

3.5.1.1 Effect of this legislation

The immediate effect of this was that freelance workers operating through agencies changed their tax models and shifted from being Schedule D self-employed freelancers to becoming limited company freelancers.^{xv} In the 1970s and 1980s there was only a marginal difference in tax rates for the two different tax models, so this had little impact, but later, as Governments focused policies to help small businesses with corporation tax cuts, this differential changed meaning so that there were significant tax advantages to people using a limited liability company.

Section 44 and the preceding legislation means that agencies need freelance staff to incorporate to insulate the agency from possible tax risks in the future, which could occur if the freelancer had been Schedule D self-employed. The knock-on effect of this clause, differentiating freelancers who invoice from temporary workers on PAYE, has been the growth of umbrella and payroll companies which has fostered, in some areas, a growth in forced self-employment. In terms of Section 44, a freelancer operating through an umbrella company is treated as if they were operating through their own limited liability company.

3.5.2 Why do clients insist that freelancers use a limited liability company?

Many clients insist that freelancers use a limited company vehicle to create a legal entity between them and the freelancer (and often between them, the agency, and the freelancer). It is considered to be a more robust model for insulating clients from tax and employment risks as it helps to remove the ambiguity of status from the perspective of the client and agency (though not for the freelancer). It also makes it easier to engage freelancers. In many industries there is a mix of freelancers and small businesses competing in the same market and this treats all such suppliers as the same.

This position was also offered up to the House of Lords Select Committee on Personal Service Companies by Robert Fort of Amey. He noted that the personal service company gives them as a client protection against tax risks. He noted that if this wasn't there, then it is likely the freelance market would be severely disadvantaged or even wiped out for larger projects.

“I would say that the benefits from our perspective are that, yes, there is a reduction in tax cost, but more importantly there is protection from tax risk. Again, if we employ somebody directly and we have to decide whether that person is employed or self-employed, all the risk sits with us. Three months later when they have gone, we get hit with a penalty from the tax office. That is a disproportionate risk for the length of the engagement. There is the tax protection and tax benefit. There is the primary operational requirement for flexibility of resources. The third area is that it saves us from what we would regard as disproportionate employment rights entitlement for what is clearly intended to be a very short-term relationship”. (Robert Fort, Amey to House of Lords Select Committee on Personal Service Companies)^{xvi}.

The fact that freelancers carry such risks themselves is part of their market offering. When there is an open market for freelance staff, who have the choice to work freelance or take permanent jobs, it works well. This is true of areas such as IT. In the Oil and Gas industry the House of Lords Select Committee was told by Dr Alix Thom that they would prefer more people to come on staff, but they prefer to work as freelance - and presumably change clients^{xvii}. In a way, this is the market in operation.

3.5.3 Tax avoidance by celebrities and senior executives

The use of a limited liability company by an individual (also known as ‘personal service companies’^{xviii}) is prevalent not just with freelancers, but also with many celebrities and many senior business executives. There have been some high profile cases of individuals setting up ‘personal service companies’ to avoid the payment of higher rate taxes in recent years^{xix}. People were surprised to discover that many well-known BBC presenters were paid in such a way. (In July 2012, it was revealed that 148 of the BBC’s 467 on-screen presenters were paid in this way)^{xx}. The BBC has announced that it was reviewing its arrangements to bring off-payroll staff onto the payroll proper.

The result of such news reports and scandals has been to tar all those who use a limited liability company to sell their services with the same brush. Policy needs to be able to distinguish between genuine freelancers (as defined in section 2.1. above) and those using such structures to avoid tax, even if it is mutually beneficial for client and worker.

In these cases it appears clear that the reason why these individuals have set up personal service companies is not for professional or business reasons, but purely for tax reasons.

The key point is that while there are tax advantages around a well-paid individual incorporating, this isn't the key driver for the majority of freelancers. For many professional freelancers, having their own limited liability company or using the services of an umbrella company are the only vehicles that they can use if they are to find work, being self-employed (Schedule D) is not an option.

We don't want tax policy targeting such arrangements to impact the genuine freelance market.

3.5.4 Issues with Section 44 for Agency Workers

Labour's policy review has noted this issue: ‘Often desperately looking for employment, workers sign contracts with payroll companies that class them as self-employed, when in practice they work for a single company. This means people can be sacked without warning, do not receive holiday or sick pay, have reduced benefit entitlements, and are also denied access to employment tribunals’. Ed Balls noted that ‘there is an important balance to be struck. Genuine self-employment should be applauded and supported, and not stifled with unnecessary and burdensome red tape’^{xxi}.

3.5.5 IR35 and tax avoidance measures

The dot com boom, the introduction of the euro, the millennium bug concerns in the late 1990s, all contributed to a huge growth in IT and business projects. Thousands of people switched to working as freelance, the majority of whom sourced work through agencies. Large tax accountant firms sprang up in place of small local accountants to advise this new army of freelancers and to do their accounts. They would propose the most tax efficient model to their clients, which was for contractors to pay themselves a minimum wage and take the rest of their income as dividends, and split these dividends with their spouse and others if they could. The model started to be introduced on an almost industrial scale. It sat firmly on the letter of tax law of what could be done, but away from the spirit of the law that local accountants tended to adhere to, which was that they would be expected to pay a reasonable amount of tax.

Naturally, HMRC's predecessor, the Inland Revenue, was concerned and the response to this in 1999 was the introduction of tax legislation known as IR35. It sought to limit the benefits of using a limited company by taxing the freelancer as an employee. At its heart of this proposition was the belief that most freelancers should be employees of

the client, not suppliers. They required that all contracts should be subjected to standard self-employment tests that already existed.

3.5.5.1 Impact of IR35

The use of self-employment tests sounds reasonable, except that there was and remains little case law to support knowledge based workers working on projects. Most case law focused on manual, as opposed to intellectual, labour; workers whose intellectual work meant that they didn't bring their own tools or arrive in a van. Their skills were specialist and it wasn't easy to provide a substitute^{xxiii} if they were unavailable. As they could be augmenting a team (like staff from other consultancies) often they weren't working independently, but co-operatively in a team often under the leadership of a project manager who may also have been a freelancer.

The result was that most knowledge based freelancers were set to fail these tests and be subjected to paying extra tax. When IR35 is applied to a freelancer's earnings it means that they are taxed as an employee (as a Schedule E) and also have to pay their own Employer's National Insurance stamp, an additional 13% of their earnings. This meant that the tax regime for freelancers became considerably worse than that of the self-employed (Schedule D) workers, since Schedule D workers don't pay Employer National Insurance contribution^{xxiii} but there was no going back to that model either because of Section 44 and client expectations.

The outcome is that these freelancers are taxed as employees, but are treated as suppliers for employment purposes.

Many new agency freelancers entering the market instead of setting up a limited liability company have instead signed up with umbrella companies. Once these umbrella schemes offered as a service the convenience of not having to maintain a company, do accounts or payroll to freelancers today, many advertise the fact that they are more tax efficient.

3.5.6 Limited Liability Companies: Our conclusion

Freelancers need to have limited liability if they are operating through the agency market and are subject to Section 44. Also many corporate firms will only deal with limited liability companies. Yet when freelancers adopt a limited liability company they inherit a corporate tax structure which can be the same as that for a 250+ person company. They can withdraw income as dividends and set up their spouses and children as shareholders to reduce the tax further and cut down on payment on employers national insurance. Elsewhere, where agencies aren't particularly involved (for instance actors, film and television camera crews and for musicians), and where the contracts are short and discrete, the need for limited liability companies isn't widespread.

Our point is that the market, to a large extent, dictates whether a freelancer needs to use a limited liability company. Yet when they do set up such a structure they are regarded with suspicion by the tax authorities who feel that they are using a company structure for their individual income. The House of Lords Select Committee report on Personal Service Companies is a good source of reference for this.

Freelancing is often criticised, not for the work that is being done or the benefits it delivers, but for the tax model that freelancers use.

A consequence is that freelancing by virtue of IR35 is considered to be an illegitimate profession. To get by, limited company contractors had to either accept this taint and pay the tax, or pretend or act like a more traditional small business. They would fret over the substitution clauses in their contracts, which said that someone else should be able to fill in for them. This may mean trying to find multiple and concurrent clients, opening an office for the sake of it, producing an additional product, or seeing some others so they look like a business, not a freelancer. In the knowledge based economy people have often gone freelance to capitalise on their specialist knowledge. Yet even IR35 recognised that just because a freelancer had to pay the taxes of an employee, they weren't actually an employee of the client, nor where they a 'worker'. In terms of workers' rights they were still a business. Professional freelancers knew that if they acquired such rights then the market for freelancers would dry up as they would be shunned by firms who didn't want such responsibilities and liabilities.

In short, we have freelancers using a business model designed for companies rather than individuals, and the HMRC using an inappropriate set of tests to stop them. Taxing them as employees but simultaneously recognising that they don't want employment or worker rights.

But the problem is really with the model in use rather than the tests. Even IR35 proffers that these freelancers aren't employees; its concern is about how much tax is being paid. At the heart of the issue is the use of limited liability companies by freelancers as a model that is not entirely fit for purpose.^{xxiv} Indeed the word 'limited liability' is a misnomer, because for the majority of freelancers it is not so much the need for 'limited liability' on assets that is required, (there are few assets for freelancers the main risk is professional indemnity), instead the requirement is for such a company so that it plugs into existing legislation for welfare, employment and tax purposes

The argument that people become self-employed or freelance not to save tax, but rather for business, economic, or professional reasons needs to be won. We should ensure that the drivers for freelancing on both sides of the equations (for freelancer and client) are in line with our definition of freelancing outlined in section 2.1. i.e., and are economic, business and professional drivers as opposed to tax drivers.

To solve this problem we believe that reform is needed around the use of a limited liability company by freelancers. Such reform needs to recognise the need for some individuals to continue to run as standard liability companies and to also take into account both tax and employment case law. A new entity to support freelancers with limited liability, that provides surety to clients, but one that will provide certainty and fairness on tax to freelancers.

In France and the USA there are specific limited liability entities for single individuals to use. Since 1 January 2011, sole traders, whether craftspeople, traders, farmers or self-employed professionals in France may opt to be classified as a sole trader with limited liability (EIRL).^{xv} They can also operate as a 'Micro-Entrepreneur' though this has certain limitations to it. In the USA, individuals can operate as a Limited Liability Company (LLC) but it is disregarded for tax purposes and they are taxed as 'Schedule C' workers - which is basically as self-employed.

Our recommendation is for the creation of a new limited liability structure for freelancers that is modelled on Community Interest Companies; this is explained in Recommendation 2 below.

4 Recommendations for a progressive government

4.1 Summary of Issues and Goals

We acknowledge freelancers as economic agents on their own account who fulfil a different role from a standard small business. The important and distinct economic role of freelancers in the modern economy needs to be:

RECOGNISED: Defined as unique economic agents providing an important and distinct economic function to employees and business owners.

PROTECTED: The unique economic value-added provided by freelancers is part of the core of the modern British economy and hence needs to be allowed to thrive.

NURTURED: It is good policy to ensure that British business always has access to a sufficient supply of high quality freelancers in order to optimise the potential of these businesses.

The three key issues are:-

1. Tackle issues of forced self-employment particularly around agency work
2. Tackle issues of tax avoidance by those who aren't freelancers
3. Clearly identify legitimate freelancers

For this the goals are to:-

Recognise

- Recognise that freelancing is a legitimate form of economic activity.
- Recognise that freelancers are today less of a shadow workforce depiction and more of dynamic economic agents that play a positive role in the economy and society
- Recognise that freelancers in some sectors are operating in competition with other businesses.
- Recognise that there are many different types of freelancers operating in different market conditions.
 - Distinguish freelancers from 'ought to be employees' (whether as bogus/forced self-employment or those masquerading for personal tax reasons) and resolving problems with forced self-employment.
 - Distinguish freelancers from small business owners – they are not the same as small business owners, they have different purposes and aspirations. It was noted that they are economic agents in their own right
 - Distinguish between freelancers who, as a group, have the bargaining power to negotiate standard contracts to deliver worker style rights from other freelancers who want individual contracts.

Protect

- Provide means to help the more precariat workforce who freelance with lower incomes and a need for protection and support. This can be around welfare and 'worker' rights.
- Encourage freelancers to organise themselves and to acquire representation.
- Remove ambiguity over tax and employment status for freelancers and so providing a safe environment for clients to engage with freelancers.

Nurture

- With freelancers clearly identifiable in the economy, proceed to building a policy framework to support them and harness their energy to drive economic growth
- Resolve the problems with IR35 and the use of limited liability companies - provide a fair model that works for individual freelancers
- Help freelancing develop as a mature business model for men and women of all ages.
- Nurture the value of freelance workers, in particular the precariat workforce, by allowing a means for them to easily move between welfare benefits and freelance contracts.

We would address these issues by agreeing a Freelancers' Charter to be a framework upon which policy could be built, bolstered by 3 other policy recommendations.

Recommendation 1: A Freelancers' Charter

A Freelancers' Charter should be adopted by the numerous freelancer groups, such that they take ownership. The Labour Party should be a similar signatory to it, and should use it as a litmus test when defining new legislation in the future.

- i. Freelancers have the right to be issued a contract for the work they are doing or otherwise assume a default basic contract. They have the right to be paid and be paid on time for the services they provide.
- ii. Freelancers should be able to compete for work and not be subject to restraint of trade by any organisation or association as a result of not having employee or larger company status. Such that clients should not discriminate against, or shy away from freelancers because of concerns over tax and employment status.
- iii. Freelancers have the right to a clear definition of their status for both tax and employment purposes.
- iv. Freelancers who compete against larger firms for business have the right to be treated as a supplier. If their status is assessed for tax or employment purposes then they should have the right to be compared with these others suppliers, not just against employees.
- v. Freelancers should not have to pay tax in advance against monies they have not yet earned.
- vi. Freelancer Workers should have the right and ability to pay some additional tax in order to opt-in to register for social welfare support and benefits between contracts. They should have the ability to move to welfare and back again without difficulty.
- vii. Freelancers should have the same professional responsibilities as an employee to uphold ethical standards.
- viii. The drivers for freelancing should be professional, economic, and business drivers, rather than ones of tax efficiency. This should apply to both freelancers and those that use them.
- ix. Freelancers have the right to be in business on their own account. Freelancers do not need to employ anyone else, have concurrent clients, or be able to supply a substitute, provide their own equipment, have a distinct work address, or even grow their businesses, to prove their status as a freelancer.
- x. Freelancers have the choice to establish a limited liability company dedicated to serve their needs in the marketplace and can use it to carry out both freelancing and traditional small business activities.

Recommendation 2: A Limited Liability model for freelancers

The incoming government in 2015 should consult on the introduction of a form of a limited liability company for a sole trader, or alternatively, a method of creating limited liability self-employment. It would consult on how this could interface with existing models, case law, and parallel legislation, such as rules for agency workers and those aimed at countering forced self-employment.

The advantage of such an approach would be to create a vehicle for all legitimate freelancers to use. There are many possible ways forward and our recommendation is that change is made.

We propose the establishment of a 'freelancer limited liability company' (FLTD). This could follow the structure defined for Community-Interest-Companies (CIC). For CIC's, a limited company is registered in the normal way but this is then registered as a CIC if it meets certain criteria. The legitimacy of this company would depend on meeting the requirements of the definition of freelancing outlined in section 2.1. A FLTD company could work in a similar way and narrow the differentials between the self-employed model and the use of a limited company, such that the choice of model is driven by business or professional concerns rather than tax efficiencies.

The criteria for registration could be a single shareholder who is the key income generator. Once registered, it would identify the operator as a freelancer. They would be restricted from many of the abuses for tax avoidance as they wouldn't be able to have their spouses or others as shareholders. However, their status as a freelancer would be recognized and it would support the charter principles (ix) that they do not need to 'have concurrent clients or be able to supply a substitute, provide their own equipment, have a distinct work address or even grow their businesses, to prove their status as a freelancer'.

We would see the creation of a Freelancer Limited Liability company (FLTD) as a vehicle to distinguish freelancers from the broader small business workforce. It could be used to limit tax avoidance and also be as a vehicle for tax credits, and to allow lower-paid freelance workers (precarious workers) to register for benefits and welfare support in between contracts. A FLTD company would qualify to be able to use micro-accounting and so reduce much

administrative burden. In the short term we would expect it to be a model for professional freelancers, but in the longer term as a vehicle to help freelance workers and the precariat workforce.

A FLTD would offer more certainty over status for both tax and employment purposes. As it could still be a limited company, it would continue to interface with existing tax and employment law and regulations (such as Section 44 and other Agency workers directives). By using this Freelancing Limited Liability Company (FLTD) there would be the following advantages:

- No need to specify a substitute
- No need to have multiple or concurrent clients on the go
- Contracts under seven months automatically considered as genuine freelance
- The ability to register for benefits between contracts
- The improved ability to gain tax credits for sickness, maternity, paternity and other leave
- Limited liability status
- Simplified accounting
- Ability to pay expenses, including training, and carry monies over to future years
- Ability to employ other staff
- Right to comparison with other suppliers (See Charter iv))

The FLTD would have the following limits:

- Single shareholder as the principal employee
- A fairly defined minimum salary/dividend split

It is noted that any such structure would need to have a safeguards to prevent vulnerable workers from being forced into it.

Recommendation 3: Ministerial responsibility for freelancers

Labour should embrace those who wish to freelance, and also those who wish to employ freelancers, in ways which do not compromise but enhance the party's core purpose of protecting the vulnerable. It should combine this with its core principles of helping people to develop opportunity and potential to grow and benefit from the full fruit of their labours by hand, or by brain. The aim therefore must be to lay the foundations to improve the legal, social, and professional status of freelancers and of freelancing as a mode of work. The importance of freelancers should therefore be recognised by a Minister within government with specific responsibility for ensuring that the needs of freelancers are addressed.

We recognise that it would not be possible or necessary for there to be a full-time Minister with responsibility for freelancers and nothing else, so we would expect this to be part of a larger portfolio, almost certainly alongside small businesses. However, since freelancing is particularly important in the creative industries, there would be a strong case for the Minister to have close links with the DCMS and DWP teams, as well as the BIS team.

Recommendation 4: Support for stronger representation for freelancers

The next government should encourage and assist where necessary the numerous groups and stakeholders representing freelancers to find common ground, and in the long term a common, if diverse, voice on issues affecting all their members.

Glossary of Terms

Term	Description
Contractor	Freelancers, usually 'professional freelancers', who work in IT and engineering.
Disguised employment	Where an individual is in effect an employee of an organization, but operates as self-employed or as a freelance professional for tax purposes.
Economic agents	The role that freelancers play in the economy that is different from a standard small business.
Forced, False, or Bogus self-employment	Individuals who should be classed as temporary workers or agency workers, but have been forced to take up self-employment contracts either directly as self-employed, or via payroll or umbrella companies.
Freelance workers	Self-employed freelancers operating through Schedule D, who wish to acquire 'worker' rights.
Inland Revenue	Now known as the HMRC.
iPros	Independent Freelance Professionals (Freelancer professionals)
Personal service company	A limited liability company owned by an individual through which they sell their services.
Precariat workers	Freelance workers, but who are predominately on lower incomes and may move between temporary agency, temporary employment, and freelance contracts.
Professionals	Professional freelancers who tend to be operating through limited liability companies who want to be engaged on business to business contracts.
Section 44	The rules affecting people and agency workers that forces freelancers to operate through a limited liability company. Concerns exists that the provisions of this are also used by umbrella firms to move temporary workers to being self-employment. Section44 of the 2003 ICTA. Formerly contained in Section 134 TA 1988 (formerly Section 38, Finance (No. 2) Act 1975).
Self-employed	Individuals operating as self-employed as Schedule D workers
Tax system and PAYE	Background to PAYE see : http://www.opsi.gov.uk/si/si2003/2682_comm.pdf
Temporary workers	PAYE workers who should acquire 'worker' style employment rights.

About the authors

Philip Ross is a member of the Labour Finance and Industry Group and an advocate of progressive small business policy in the Labour Party. In 2012, he re-launched the Labour Small Business Forum as a network of Labour members and supporters who work for themselves at well attended fringe meeting at the Labour Conference in Manchester, which he organised and chaired. In 1999, while working as a freelancer he helped to form the Professional Contractors Group, which is a trade association for freelancers. In 2012, he published his book 'Freedom to Freelance' that traces the formation of the group and their struggles to get all the political parties to understand the importance of freelancing and small business in the new economy. Though no longer a freelancer, he now works for a small business (in which he has an equity stake), but remains well informed and committed to promoting the values of small business, freelancers and the self-employed.

Andrew Burke holds the Bettany Chair and is the founding Director of the Bettany Centre for Entrepreneurship at Cranfield University. He is also a member of the Board of Cranfield Ventures Limited - the University's tech transfer unit. Previously, he was the Director of Graduate Programmes and a member of the Executive at Cranfield School of Management. He has been on the faculty of Warwick Business School, the University of Edinburgh, Trinity College Dublin, Balliol College Oxford, and the University of St Andrews. He is a Visiting Professor at the Anderson School of Management, UCLA, USA. He was a Research Professor at the Max Planck Institute for Economics, Germany from 2003-2009.

Andrew is widely published in top-ranked international journals, including the Harvard Business Review, Journal of Management Studies, Regional Studies, International Journal of Industrial Organization, the Oxford Bulletin of Economics and Statistics, and Small Business Economics. His work has been presented to the EU Commission, World Trade Organization, HM Treasury, UK Houses of Commons, and Lords as well as through media, such as BBC Breakfast Television and the Working Lunch.

Andrew is founding editor of the International Review of Entrepreneurship and was a guest editor of the International Journal of Industrial Organization. He is on the editorial boards of the International Small Business Journal, the International Journal of Business Innovation and Research and the International Journal of Research, Innovation and Commercialization. He has acted as a consultant for organisations such as the European Commission, Businesslink UK, GESAC (EU), Forbairt (IDA), Hudson Contract, Schlumberger, Selex-Galileo, May Gurney, Bank of Ireland International Banking, the Irish Music Rights Organisation, and the UK Professional Contractors Group (PCG). He also has a portfolio of new venture investments.

End Notes

- ⁱ Labour's Small Business Task Force (2103), An Enterprising Nation. Recommendation 33.
- ⁱⁱ Kitching, D. (2014), The Growth of Freelance Working in the UK: 1992-2013. Kingston University, paper presented at the PCG First Global Research Workshop on Freelancers and IPros, June 2014, London.
- ⁱⁱⁱ Research paper presented at the SCALES Conference at Erasmus University Rotterdam, December 2013 entitled 'The impact of Freelancers on Business and Economic Performance' by Professors Andrew Burke (Cranfield University) and Marc Cowling (Exeter University).
- ^{iv} Kitching, D. and Smallbone, D. (2012), Exploring the UK Freelance Workforce, 2011, Kingston University, published by PCG, London.
- ^v Burke, A.E. (2013), The Economic Role of Freelancers in the Construction Industry (2nd Edition), Cranfield University, published by Hudson, Yorkshire.
- ^{vi} The PCG told us that their researched showed that "additional demographic data which suggests that four out of ten freelancers are women, and in some sectors such as healthcare management, therapy and nursing three quarters are women. The number of freelance working mothers has increased by almost a quarter since 2011. Under 29s are the fastest growing segment of the freelance workforce."
- ^{vii} <http://www.thersa.org/action-research-centre/enterprise-and-design/enterprise/enterprise/the-power-of-small> and <http://www.cityam.com/article/1395711130/self-employed-outnumber-public-sector>
- ^{viii} Burke, A.E. (2012), The Role of Freelancers in the 21st Century British Economy, Cranfield University, published by PCG, London.
- ^{ix} https://www.rec.uk.com/__data/assets/pdf_file/0014/124052/rec-flexible-work-commission-report.pdf
- ^x Burke, A.E. (2012), The Role of Freelancers in the 21st Century British Economy, Cranfield University, published by PCG, London include diagram above.
- ^{xi} See HMRC for a formal definition of a worker
- ^{xii} These notes are supported by unpublished appendices, which can be made available
- ^{xiii} Some of the key status tests used by HMRC to assess whether freelancers are genuinely self-employed are whether they can supply a substitute person to do their work or have multiple clients on the go at one time. But this seems to contradict the fact that freelancers are sole independent workers, and the concept of having a substitute for their work or running multiple clients at once is often beyond their personal capacity. These tests are out of kilter with the reality of freelancing and their application needs to be reviewed.
- ^{xiv} Once people have chosen to freelance however they will look for the most tax efficient model. The PCG's data supports the fact that freelancers use limited companies for reasons other than. tax, 54% do so because their client or agency will no engage them otherwise.
- ^{xv} http://www.contractorcalculator.co.uk/contractor_sole_trader.aspx
- ^{xvi} <http://www.parliament.uk/documents/lords-committees/Personal-Service-Companies/personalservicecompaniesevvolume.pdf> Page 303
- ^{xvii} "We need to have some flexibility in the market to deal with peaks and troughs, but from our perspective things have gone too much the other way. It is not so much a feature of manpower planning; the level of use of PSCs is driven by individuals themselves, so we are not controlling the proportion." Dr A Thom - <http://www.parliament.uk/documents/lords-committees/Personal-Service-Companies/personalservicecompaniesevvolume.pdf> p304
- ^{xviii} There is no legal definition of a 'personal service company', it is usually interpreted as a Ltd liability company owned by an individual through which they sell their 'personal' services (presumably opposed to selling goods).
- ^{xix} <http://www.bbc.co.uk/news/entertainment-arts-24851127>
- ^{xx} <http://www.telegraph.co.uk/culture/tvandradio/bbc/9404090/How-148-BBC-performers-avoid-paying-full-tax-rate.html>
- ^{xxi} <http://www.yourbritain.org.uk/agenda-2015/policy-review/bogus-self-employment>
- ^{xxii} Substitution clauses are religiously added to most contracts, but they are rarely, if ever, exercised. This is mainly because clients in the knowledge economy aren't usually that happy about accepting an unknown substitute to step in and carry on with a complex piece of work. They are only in the contracts to appease the rules on IR35. In fact, there are no hard and fast rules and subsequently little certainty as to whether a contract passes the test. HMRC have a phone line for people to call, but the anecdotal legal advice is that only those who are at risk would call, and if you call you draw attention to yourself, so hardly anyone ever calls it.
- ^{xxiii} <https://www.pcg.org.uk/ir35>
- ^{xxiv} Outside of the tax issue when other freelancers in say, television and film, or musicians, have needed limited liability status and have set up a company they can find that because they are no longer engaged as a self-employed, individual are instead a company they can lose some of the contractual benefits that they may have had.
- ^{xxv} <http://www.notaires.fr/notaires/en/the-limited-liability-of-sole-trader-status>