

Employed or self-employed?

The question as to whether someone is employed or self-employed is not as straightforward as it might at first appear. Many people assume they are free to choose, but HMRC emphasises that this is not the case.



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How do you decide?

Although there is no clear-cut answer to this question, HMRC has a series of guides for tax and national insurance contributions. This sets out the steps and a series of questions to test the particular circumstances of any working relationship. These cover areas such as:

- Ultimate control of work
- Personal service
- Right of substitution
- Basis of payment
- Holiday pay, sick pay and pension rights
- Part and parcel of the organization
- Right to terminate a contract
- Opportunity to profit from sound management
- Personal factors
- Length of engagement
- Profit element, and risk of loss
- Provision of materials and equipment
- Integration with the employer's business
- The intention between the parties
- Mutuality of obligations
- Usual conditions in the industry
- Intention of the parties

Note, it must be emphasized that status is not running through the above checklist, it is rather a matter of assessing the overall picture that emerges from consideration of the facts. These are matters of general employment law, and not specific tax legislation.

This is a developing area, with those working in the 'gig' economy, such as drivers for Uber, challenging their "employer's" view that they are self-employed to seek employee or worker rights, including paid holiday and membership of an auto enrolment pension arrangement.

Although recent cases heard by the Employment Tribunal are not effective for tax purposes, it is very likely that the tax treatment of the self-employed, and indeed self-employed status will be reformed before too long.

The Uber decision, which rules that drivers were "workers" – a slightly less favourable status than employees – is under appeal by Uber. Gross profit/sales.

It may be tempting to cut payroll costs by engaging former employees as self-employed contractors. There are risks attendant with this strategy but if done correctly this can be a tax efficient approach.

For HMRC to accept the self-employed status it should be evidenced that:

- The worker operates a business assuming risks such as rectifying work, invoicing and waiting for payment
- The worker is not required to work for a particular engager
- The engager is not obliged to use that worker's services; and
- The engager does not have the right to control what the worker does

A person is generally classified as a 'worker' if:

- They have a contract or agreement to do work or services personally for a reward;
- Their only reward is for money or a benefit in kind;
- They only have a limited right to send someone else to do their work;
- They have to turn up for work even if they don't want to
- Their employer has to have work for them to do as long as the contract or arrangement lasts; and
- They aren't doing the work as part of their own limited company in an agreement where the "employer" is actually a customer or client

HMRC has also developed a series of points based entity tests. A business will be scored on a number of key criteria which can enable them to review if they are a low, medium or high risk of being caught by the IR35 legislation and how he does it.

Where a contractor is engaged through his own limited company, the engaging business does not carry a risk that he will be recategorised as an employee. Instead special tax rules known as the intermediaries legislation or IR35 may apply. These use a similar test to establish the tax treatment of the contractor, but it is the contractor who bears the PAYE and NIC if the rules apply.

In our experience, most businesses have room for profit improvement in one or more of these areas.

What are the practical differences?

Employees are taxed under the PAYE system and are liable to Class 1 national insurance (NI) contributions. If the worker is an employee, the employer also has to pay Class 1 NI on earnings over a limit set each year. Above this rate (£866 p.w. for 2017/18), the employee's NI rate then reduces to 2%, but for employers, NI continues at the full rate, with no upper limit.

Employment allowance

Most businesses, all charities and CASC's are entitled to an annual 'employment allowance' of £3,000 to reduce their liability for class 1 secondary national insurance contributions. Where a company has a single paid employee who is a director the allowance is not available.

The second employee must be paid at above the secondary earnings threshold (£157 pw for 2017/18) for at least one pay period in the tax year.

Employees (and workers) are also entitled to be paid the National Minimum Wage (or perhaps the voluntary Living Wage) for hours worked. In contrast, there is no such requirement to pay self employed contractors minimum rates of pay.

The employer also assumes responsibility for paying statutory payments such as statutory sick pay and statutory maternity pay. Employers are also responsible for registering through the auto-enrolment regime, meaning that employees have to be enrolled in a pension scheme to which the employer is required to make contributions.

If you are the sole director and you have no other staff working for you, the company does not have automatic enrolment duties. Where there are several directors, none of whom has a contract of employment this is also the case; the company merely needs to notify The Pensions Regulator that it has no duties under auto enrolment.

Employees have rights under health and safety and employment laws, such as the rights to redundancy payments and not to be unfairly dismissed. Moreover, the range of social security benefits is greater for employees than for the self-employed.

However, since the introduction of the single tier state pension, the rights of the self-employed as regards state pension are the same as those of employees.

Self-employed workers are taxed under self-assessment, and are allowed more scope in claiming expenses. They also pay Class 2 and Class 4 NI contributions, the combined burden of which is lower than Class 1 NI. Their 'employers' are not subject to NI.

It is not surprising, therefore, that many businesses show a marked preference for self-employment status for their workers!

What if you are wrong?

It is usually the responsibility of the person making the payment to get it right. If you treat a worker as self employed and he or she is subsequently ruled to be an employee, you could find that all the payments you have made will be treated as net payments, and you will have to pay the corresponding tax and employees' NI, as well as the employer's NI.

You may also have to pay interest and penalties.

Can you create conditions to favour self-employment?

If you want to substantiate a classification of a worker as self employed, we strongly recommend that you have drawn up and enforce a suitable contract defining the services provided. In line with the tests referred to above, you will need to give particular consideration to the following points:

Pricing

One of the main requirements is that self employed workers bear some element of risk in the arrangement, which means you will have to avoid the 'hourly rate', in favour of a 'price for the job'. The main principle is that the price, scope, and timing of the work should be agreed, and evidenced in writing, before the job commences.

Workmanship

Within reason, the more freedom the worker has in the detail of the way the work is carried out the better. You must also make it clear that the worker will have to put right any faulty work at his or her own expense.

One of the strongest tests of self employment is the right to substitute a worker who is equally capable of carrying out the work.

All self employed workers should hold public liability insurance.

Provision of equipment

Where practical, the worker should supply at least some of the important equipment or tools. Of course, the extent to which equipment is required depends upon the nature of the work.

What about personal service companies?

These guidelines apply equally to the so called 'IR35' rules to test whether a worker would be treated as an employee of the client, if it were not for the existence of an intermediate service company. Generally, however, in this circumstance it is the responsibility of the personal service company to decide if the contract is one of employment and any liability for treating it incorrectly is also that of the personal service company. The personal service company is responsible for operating PAYE and NIC's on the receipt of payments from any contract that does not satisfy the 'IR35' rules.

However, from April 2017, contractors working through their own limited companies, but engaged on work in the public sector (broadly, Government departments, local councils, schools, universities, NHS trusts and other public bodies) will be subject to PAYE and primary NIC on the payments made to their companies if the payer decides that they fall within IR35; in other words, the burden of proof has been removed from the contractor, and placed on the public sector engager, or the agency through which the contractor is paid.

Visit the HMRC site for their view on employment and self employment.

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Taylorcocks chartered accountants & tax advisers

Speak to an expert today

Website: www.taylorcocks.co.uk

Email: enquiries@taylorcocks.co.uk

Phone: 0330 088 7111

3 Acorn Business Centre, Northarbour Road, Cosham, PO6 3TH