

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 state this is not the case.

How do you decide?

Although there is no clear-cut answer to this question, HMRC has issued a series of guides for tax and national insurance contributions (NICs) regarding whether an individual is employed or self-employed.

These set 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 the work
- Personal service
- Right of substitution
- Basis of payment
- Holiday pay, sick pay and pension rights
- Part and parcel of the organisation
- 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.

It must be emphasised that arriving at the correct status is not just a matter of 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 an ever-developing area, with those working in the 'gig' economy challenging their employer's view that they are self-employed in order to seek employee or worker rights, including paid holiday and membership of an auto-enrolment pension arrangement.

The term "worker" is an important employment rights term, entitling workers to a variety of employee-like benefits, but has no meaning in tax law.

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 other arrangement to do work or services personally for a reward;
- Their 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 last; and
- They aren't doing the work as part of their own limited company in an arrangement where the 'employer' is actually a customer or client.

If someone is engaged directly by a business on a self-employed basis and this later proves to be incorrect, HMRC will look to the engager rather than the self-employed contractor for the PAYE and NICs that should have been paid. This means the financial risks are considerable if self-employed contractors are reclassified as employees.

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 NICs if the rules apply.

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.

What are the practical differences?

Employees are taxed under the PAYE system and are liable to Class 1 NICs. 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 (£892 a week for 2018/19), 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 CASCs 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 (£162 a week for 2018/19) 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, statutory maternity pay and statutory paternity pay.

Employers are also responsible for registering for auto-enrolment, meaning employees have to be enrolled in a pension scheme where the employer is required to make contributions.

It is possible for the employee to opt out - this lasts initially for a period of 3 years. If the employee opts out, or stops contributions to the scheme, the employer is required to automatically enrol the employee into the scheme at a later date (normally every 3 years), if the employee is an eligible jobholder at that time.

If you are the sole director and you have no other staff working for you, the company does not have automatic enrolment responsibilities. 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 auto-enrolment duties.

Auto-enrolment duties for employers commence as soon as an employee is taken on, so businesses taking on their first employee will need to ensure they start off on the right foot, by assessing their first member of staff to check whether they are entitled to be auto-enrolled and then by setting up a scheme and making payments within 6 weeks.

The minimum mandatory rate of contributions by employees and employers increased on 6 April 2018, with employers required to pay 2% of earnings and employees a minimum of 3% of earnings. These rates rise again on 6 April 2019 to 3% for employers and 5% for employees.

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 (in operation from 6 April 2016), 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 NICs, 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 that establish the worker as self-employed?

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 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 the construction industry?

The construction industry is subject to exactly the same rules as any other type of industry. However, there are some special considerations.

Where the work entails use of **heavy equipment or expensive plant**, it is sometimes recommended that contractors hire the equipment to their subcontractors, who then include the cost within their 'price for the job'.

Such arrangements may seem artificial, and there is the danger that with substantial hire costs being included in the pricing, the subcontractor's turnover may breach the VAT threshold and therefore require them to register for VAT. However, this is not necessarily a bad thing because VAT registration is often cited as further evidence of self-employment.

With regard to **pricing work**, a competitive tender is best, but in practice it should not really matter who makes the first suggestion of an appropriate price.

Although there is a **special scheme for taxing construction industry workers**, registration as a subcontractor under the scheme in itself does not necessarily prove self employment status.

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.

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.

Contact us if you would like further help or advice on this subject.