

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 HM Revenue & Customs emphasises that this is not the case.

How do you decide?

Although there is no clear-cut answer to this question, HM Revenue & Customs have placed emphasis on reclassifying individuals claiming to be self-employed. They have published two leaflets (ES/FS1 *Employed or self-employed for tax and National Insurance contributions* and ES/FS2 *Are your workers employed or self-employed for tax and National Insurance contributions?*), which set out a series of questions to test the particular circumstances of any working relationship. These cover areas such as:

- Ultimate control of the work
- Working for a number of people
- Profit element, and risk of loss
- Correction of faulty work
- Provision of materials and equipment
- Working hours
- Integration with the employer's business
- The intention between the parties
- Usual conditions in the industry

Note, however, these are matters of general employment law, and not specific tax legislation.

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 – over a limit set each year, the employee's NI rate reduces to 2%, but for employers NI continues at the full rate, with no upper limit. The employer also assumes responsibility for paying Statutory Sick Pay and Statutory Maternity, Adoption or Paternity Pay.

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.

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 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 have no right in law to recover such items from your employees after the event.

You may also have to pay interest and penalties for incorrect returns.

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.

Substitution

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

Insurance

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 force him or her 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**, the fact that a subcontractor is registered does not, in itself, 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. There are further rules for “Managed Service Companies”.

Employment Status Indicator (ESI)

HMRC have introduced an online ESI tool which can be used in working out employment status of individuals or groups of workers. The link can be found at www.hmrc.gov.uk/employment-status/index.htm

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