

## CORPORATE & BUSINESS TAX

# Employed or self-employed?



***Employers sometimes ask the Wise & Co Team about classifying workers as employed or self employed – a surprisingly complex issue. Here is an overview of the key points.***

***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 (HMRC) emphasises that this is not the case.***

### **How do you decide?**

Although there is no clear-cut answer to this question, HMRC has published an introductory guide - 'employment status' (see <https://www.gov.uk/employment-status>).

This covers areas such as:

- Who is a worker?
- Employment rights
- Casual or irregular work
- Employment shareholder jobs
- Self-employed and contractors
- Working out if someone is self-employed
- Directors and office holders.

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 contributions (NICs). If the worker is an employee, the employer also has to pay Class 1 NICs. Over a limit set each year, the employee's NICs rate reduces to 2%, but for employers NICs continue 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 NICs, the combined burden of which is lower than Class 1 NICs. The individuals or businesses they do work for are not subject to NICs.

### 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 they are 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 employee's NICs, as well as the employer's NICs. 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.

The classification of a worker as self-employed can be supported by having drawn up a suitable contract defining the services provided. Every case is looked at on its own facts, but 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 the worker would put in a bid or quote for the work to be completed. The worker is able to make more profit by working more efficiently or may incur a loss if the work overruns. 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. A self-employed worker will generally control most aspects of the work to be carried out. You must also make it clear that the worker will have to put right any faulty work at their own expense.

### Substitution

One of the strongest tests of self-employment is the worker has the right to substitute their own personal services for another worker who is equally capable of carrying out the work, however this may not always be possible if the worker is engaged because of their personal reputation or specific skills.

### 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".

## The Check Employment Status for Tax (CEST) tool

HMRC has an online CEST tool which can be used in working out the employment status of individuals or groups of workers. The link can be found at:

<https://www.tax.service.gov.uk/check-employment-status-for-tax/disclaimer>

HMRC has enhanced the CEST in recent times but commentators still have reservations about its accuracy in all cases. Please contact us if you would like further help or advice on this subject.

If you are an employer and would like more advice on classifying a worker as employed or self-employed, get in touch with the Wise & Co Team.

*Last updated in August 2020.*