

The vexatious question of whether an individual is employed or self-employed continues to be a key concern for businesses, as well as an area that HMRC employer compliance teams and status inspectors focus on. Readers could be forgiven for thinking we have been here before, and that they are sufficiently aware of the basic issues in determining status and the consequences of incorrectly treating a person as self-employed. However, there are still many aspects of status that do not appear to be common knowledge and that could still catch out an unwary engager.

how, where, when and what work is done? The greater the level of control, the more likely that the relationship is one of employment.

- **Financial risk** – Does the individual take genuine financial risk? For example, does the individual provide the same services to other customers? Do they run the risk of making a loss if the work is not delivered on time or a profit if they exceed targets? Do they have their own business premises? Do they provide their own equipment and are they responsible for their own professional indemnity/public liability insurance? The greater the level of financial risk to the worker, the more

for the employer's NIC plus interest and penalties thereon.

The very brief outline above hardly does justice to the sometimes painstaking process of deciding on the correct treatment. Further help is available from HMRC by way of the employment status indicator online tool, or a formal status ruling can be sought from the tax office; although both these options have their drawbacks.

So, while arriving at a correct decision can be problematic enough, there are a number of other pitfalls and considerations that are lesser known and can apply in addition to the above tests, even overriding them in some cases.

SELF-EMPLOYED OR NOT?

Applying the basic principles of employment status is difficult enough, but there are other special rules and pitfalls that make it harder still. *John Harling* considers them

Basic principles

Of course, the first question that should be asked is whether an individual worker is employed or self-employed under basic principles. Case law over many years has given us the so-called tests of employment status to determine whether the individual is working under a contract of service (employed) or a contract for services (self-employed). These are numerous, and it is beyond the remit of this article to consider them all in detail. However, it would be fair to say that the three main considerations in determining whether an individual is employed or self-employed are:

- **Personal service** – Does the individual have to provide the services personally or can he/she provide a substitute? If there is a genuine right to provide a substitute and the individual pays them personally, this is a very strong indicator of self-employment.
- **Control** – Does the engager exercise control over the individual in terms of

likely it is that they are truly self-employed.

We are reminded that it is not a simple box-ticking exercise, since some tests carry more weight than others, depending on the work that is being undertaken. However, it does provide a framework for the engaging company or organisation to make a judgment on the correct status so it can either treat the worker as an employee subject to PAYE and Class 1 National Insurance contributions, or as self-employed and pay them gross, leaving them to sort out their own tax affairs.

Where an individual has been incorrectly treated as self-employed, HMRC will seek to recover retrospective PAYE, NIC, interest and penalties. In some circumstances, HMRC may allow a transfer of the liability from the employer to the deemed employee, although this is by no means guaranteed and the deemed employer will always be liable

Officeholders

Where an individual is deemed to be the holder of an office then he or she is treated the same way as an employee for tax and National Insurance purposes in respect of payments made regarding that office. This applies notwithstanding the basic principles outlined above.

Rather unhelpfully, there is no statutory definition of the word 'office'. However, it has been judicially defined as a 'permanent, substantive position which had an existence independent from the person who filled it, which went on and was filled in succession by successive holders'. (Rowlatt J in *Great Western Railway Company v Bater* 8TC231.)

Therefore, a number of posts fall within the definition of officeholder, such as company directors (including non-executive directors) and company secretaries. There are many instances where individuals in such positions have received gross payment for performing these roles. Of course, a non-executive

director may provide other consultancy services to a company on terms that support self-employment; however, if there is no clear distinction between the non-executive and consultancy roles, HMRC will always challenge such arrangements.

In the public sector, all schools in England and Wales must appoint school improvement partners (SIPs) to work alongside the head teacher over a period of, typically, three years. Many SIPs have been engaged on a self-employed basis, possibly because they are not involved in the day-to-day running of the school and are not subject to a significant level of control. However, because an office has been created by law, an SIP must be treated as an employee for tax/NIC purposes.

Special National Insurance rules

Under the Social Security (Categorisation of Earners) Regulations 1978, individuals performing certain types of work must be treated as 'employed earners' for National Insurance purposes even if they are self-employed under general principles. This means that employers' and employees' NIC must be accounted for on the payment, notwithstanding the fact that the individual pays tax on a self-employed basis. This includes teachers/lecturers, entertainers and ministers of religion.

For teachers and lecturers, the regulations apply to anyone giving instruction in an 'educational establishment' unless they agree in advance to give the instruction on no more than three days in three consecutive months or it is given as a public lecture. The definition of educational establishment is very widely drawn and goes beyond a traditional school or college.

HMRC has recently carried out a consultation on the practical aspects of applying the rules in various sectors, and intends that with effect from 6 April 2010 they will apply to all teaching/lecturing and instruction of a vocational or academic nature wherever it is given (except in a private dwelling where the teacher is paid directly by the student). Full details will be made available shortly.

These rules have significant implications for many different types of business, and should be considered in all cases where training, instruction or teaching is provided by individuals who

may be caught by the rules even if they are self-employed for tax purposes.

Personal service companies and IR35

As a result of legislation introduced by *Finance Act 2000* – the so-called IR35 rules – where services are provided via an intermediary such as a personal service company or partnership, on terms that would be considered as employment but for the existence of the intermediary, PAYE and Class 1 NIC must be accounted for by the intermediary on payments made.

Consequently, it is not uncommon for companies to enter into arrangements whereby some of their service providers set up one-person limited companies so they can be paid gross in the first instance and are responsible for their own PAYE/NIC arrangements. There are also rules aimed at managed service companies – more complex structures than personal service companies – which are also required to operate PAYE/NIC where they work on terms that are akin to employment.

However, great care should be taken in such cases, as the IR35 rules might provide some protection to the engaging company in its obligations to operate PAYE/NIC. What it does not do of course is to provide employment law protection, and there are many cases where individuals operating via intermediaries have later successfully claimed employment rights.

It should also be borne in mind that it is highly unlikely that IR35 will provide protection to the engaging body when considered in conjunction with the officeholder rules as described above. In the case of a non-executive director, it is the individual who is appointed to the position and PAYE/NIC must be operated even if services are provided via an intermediary arrangement.

Agency workers

Employment agencies provide many businesses with workers who are not strictly employees. However, special rules are in place so that these workers are treated the same as employees for tax/NIC purposes.

Where an individual is provided via an employment agency, it is the agency that operates PAYE/NIC and, therefore, this is not generally the concern of the client company to whom the services are being provided. However, if the agency is based

outside the UK – and remember the Isle of Man and the Channel Islands are not part of the UK – then the client company is likely to be required to operate PAYE/NIC if, as is likely, the agency does not do so.

Construction industry

During 2009 the government undertook a consultation on radical new proposals to tackle what it perceives to be false self-employment in the construction industry (see *Tax Adviser*, November 2009, p41). The government has made various attempts over many years to reduce the proportion of self-employed construction workers, and this is the most far-reaching proposal yet.

We await further details, but it is proposed that for those businesses in the mainstream construction industry, all construction workers they engage will be treated as employees for tax/NIC purposes unless they meet at least one of three criteria:

1. The worker provides all plant and equipment (excluding small tools).
2. The worker supplies all materials.
3. The worker provides other workers to carry out the work (and is the payer).

Therefore, should these proposals become law, employment status for these workers is to be dealt with by a statutory framework that can take priority over the general principles. Understandably, these proposals have caused some concerns within the construction industry, because its costs will increase and it will face being treated differently from other business sectors.

Summary

In considering the risk posed by this issue in a business, it is only right and proper that the starting point should be the principles established by case law. However, it is very important that the next step should then be to consider the special rules that operate in addition to these and which can in certain cases override them. Employment status is the most rigorously reviewed area when HMRC undertakes employer compliance reviews, and businesses and organisations need to consider all the various rules that could potentially catch them out.

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