

# Employment status

Examining the status of employees and the resulting tax implications.

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he tax treatment for the payment to an individual, where they are engaged directly with a business/organisation, depends on the nature and practical application of the services undertaken.

Where the individual is engaged directly, there are many factors involved in deciding whether that individual is employed or self-employed. No precise definition of self-employment exists for either tax or National Insurance Contributions ("NIC") purposes. In many cases, deciding the correct relationship between the parties is straightforward, but in some cases it is a complex and difficult decision.

Individuals cannot choose whether they are to be classed as self-employed or as an employee. The circumstances of their engagement will determine the status and unfortunately the burden of this decision initially lies with the business/organisation, and then for them to make the necessary tax deductions and/or NIC, as appropriate.

## Contract 'of' or 'for' services?

Everything starts with the contractual arrangements. This will be HM Revenue Customs (HMRC) default when considering any status case (before considering practical day-to-day operations).

Case law has dictated two different forms of contract when considering status:

- A contract of service; and
- A contract for service.

A contract **of** service indicates employment whereas a contract **for** services indicates self-employment.

A contract **of** service provides for a master/servant relationship with the worker taking direction from, and being under the control of, a third party whom they are 'serving'.

On the other hand, a contract **for** services usually relates to the completion of a specific task, or tasks, without the master/servant relationship.

It is important to note, however, that where the contract does not reflect the true relationship, in practice, HMRC will ignore it when determining the status.

## Factors of employment

Contract arrangements are one element that needs to be considered when determining employment status. As there is no one piece of legislation that is definitive in its determination of status, other tools need to be used to ensure an accurate assessment of an individual's

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employment status is made. Precedent, through HMRC practice and case law, has ensured the 'factors of employment' are the consensus tools to use for the determination of employment status.

None of the criteria listed below can, in isolation, be taken as determining employment status. It is the overall balanced view, after taking all of them into consideration, which will determine whether an individual is employed or self-employed.

The factors that may determine the employment status are:

1. Control
2. Mutuality of obligation
3. Financial risk
4. Integration
5. Substitution/delegation

## Control

Who decides where, when and how the work is done? An employee will not normally have ultimate control over these factors.

A self-employed individual is more likely to have flexibility within an overall framework to control:

- their own hours;
- location of work;
- whether to accept a contract/project; and
- who they work for.

The greater the level of control, the more likely that the relationship will be one of employment.

## Mutuality of obligation

Although HMRC has played this criterion down, it is a factor the courts have taken into account. If a business/organisation does not have to offer projects or services to an individual and the individual can refuse to accept such an offer for projects or services, this is an indicator of self-employment.

## Financial risk

An employee usually bears no real financial risk, being paid a regular rate of pay, and has benefits such as holidays, sick pay, overtime pay and pension rights (which are not available to the self-employed worker).

The greater the degree of financial risk the more likely the worker is to be self-employed.

Such risk could (but not always) include:

- having a definite task at a fixed price which may be vulnerable to delay
- having to put right defective work at their own cost

- being involved in competitive tendering for contracts
- requiring public liability insurance
- bearing running costs or paying for materials or overheads.

## Integration

If the individual performing the services is an integral part of the business for which they are working or is part and parcel of the business/organisation's activities and structure, they are likely to be an employee.

For example, whilst a hospital board may not be able to control how surgeons perform their work, they are likely to be under a contract of service if the operations they perform are an integral part of the hospital's activity.

## Substitution/delegation

Substitution used to be a determining factor for self-employed status and can still be given the right circumstances. Whilst many engagements of individuals are for their personal experience and expertise and, as a result, substitution may not be an option, many more can allow for indirect substitution, where the services are the responsibility and accountability of the individual, but they may need assistance in completing all tasks.

Where an individual can usually send someone in their place or can obtain additional help from sub-contractors, at their own expense, this will be a strong indication of self-employed status. Whereas an employee is normally responsible for completing the tasks set with any substitution or additional assistance being determined and provided by the employer.

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## Off payroll intermediary rules (IR35)

IR35 is a tax legislation that is designed to tackle tax avoidance by individuals supplying their own services through an intermediary, usually a Personal Service Company (PSC).

Currently, where such a contractual relationship is bona fide, a business/organisation is protected from any PAYE and NIC exposure by the so called IR35 legislation. This is the case even where the relationship between the business/organisation and the individual could be determined an employed relationship were it not for the PSC.

From April 2020, such protection for businesses/organisations will be abolished. At this time, where a business/organisation engages with an individual's PSC to provide services, it will need to undertake an assessment (using the factors of employment) and make a determination as to whether the engagement is:

- self-employed; or
- deemed-employment.

The assessment will need to be recorded and the status determination communicated to the individual. HMRC has suggested such determination will need to be made prior to the engagement going live.

Where deemed-employment status is determined, PAYE and NIC will need to be operated on the fees paid to the PSC (less deductions for VAT, genuine business expenses, etc.) For the purposes of this new regime, deemed-employment does not provide the right for the individual to receive normal rights afforded to 'employees'.



**Andy Timpson**

Partner  
Employer Services

T +44 (0)20 7544 8899

E [andy.timpson@blickrothenberg.com](mailto:andy.timpson@blickrothenberg.com)

Independent  
Member of

**B K R**  
INTERNATIONAL

**B R** BLICK  
ROTHENBERG

a CogitalGroup company

16 Great Queen Street  
Covent Garden  
London WC2B 5AH

T +44 (0)20 7486 0111  
E [email@blickrothenberg.com](mailto:email@blickrothenberg.com)  
W [blickrothenberg.com](http://blickrothenberg.com)