

International Business Review

Employees vs the self-employed contractor

UK tax implications

Your employment status determines the basis on which your income is taxed and the level of national insurance contributions (“NICs”) which are to be paid. Also, your employment status has an impact on employment rights, benefit rights and employment law.

When you work for someone else, it is important to establish whether you work for them as an employee, or a self-employed contractor, to ensure that you are fully compliant with tax legislation while maximising the benefit of any deductions that might be available.

1. To determine employment status

Consider the nature of the contract that an individual has. If it is a ‘contract of service’ the individual is an employee. If they work under a ‘contract for services’ they are self-employed. There is no statutory definition for tax purposes of these two forms of contract but there are common law principles that can be applied.

Employee

If you mainly answer ‘yes’ to the following questions, you are most likely to be treated as an employee for tax purposes:

- Do you have to do the work yourself?
- Does someone allocate tasks to you, specifying a timeframe and where to carry out the tasks?
- Do you work a set amount of hours (as specified in your contract)?
- Can someone move you from task to task?
- Are you paid a fixed amount per month?
- Are you entitled to overtime pay or eligible to be part of a bonus scheme?

Self-employed / contractor

If you mainly answer ‘yes’ to the following questions, you are most likely self-employed or a contractor

- Can you hire someone else to do the work for you, or engage helpers, at your own expense?
- Do you risk your own money?
- Do you provide the main items of equipment needed to carry out the job (not just the small tools many employees provide for themselves)?
- Do you agree to a job at a fixed price, regardless of the time taken to complete the job?
- Can you decide what work to do, how and when to do the work and where to provide the services?
- Do you regularly work for a number of different people?
- Do you have to correct unsatisfactory work in your own time and at your own expense?

The guidelines detailed above also apply when an individual is working part-time, or if they have more than one job. Even in these cases, the individual must be able to answer ‘yes’ to all the considerations that determine self-employed / contractor status to be eligible for that status, and this applies for each job. It is possible to be both employed in one job and self-employed in another at the same time.

If you use an intermediary to provide services, for example a limited company or partnership, specific legislation regarding tax and NICs applies.

2. Why does it matter?

Employee

If you are an employee, it is the responsibility of your employer to collect tax and Class 1 NIC out of your earnings via pay as you earn ("PAYE") and pay it to HM Revenue & Customs ("HMRC").

It should also be noted that, as an employee, expenses incurred that are not reimbursed by your employer can be claimed as a deduction for tax, so long as they are incurred wholly, exclusively and necessarily in the performance of your duties for your employer.

Self-employed/contractor

Being self-employed or a contractor means that it is your responsibility to pay tax and NIC to HMRC. To do this, firstly you need to inform HMRC that you are self-employed by 31 January following the end of the tax year in which the self-employment commenced. If you fail to register your status you will not only incur a minimum £100 penalty, but also potentially up to 100% of tax underdeclared by failing to register.

Secondly, you must submit a tax return that includes self-employment pages to inform HMRC of your taxable profits. The due date for submitting paper returns is 31 October, and for electronically submitted returns is 31 January. Failure to pay your tax bill by 31 January following the end of the tax year will result in interest and surcharges.

If self-employed or a contractor it will also be necessary to pay Class 2 and Class 4 NIC. The rates of NIC between an employee and a self-employed/contractor differ.

Overseas business

If you are an overseas business engaging an individual in the UK, it is important to be clear whether you are taking on an employee or a contractor. If it is an employee, then you may be creating a permanent establishment in the UK. If self-employed or a contractor, then this may not be the case but you need to be absolutely certain. Many people prefer to say they are self-employed rather than employees, due to the more beneficial tax treatment. The onus is on the "employer" to ask the questions.

Our recommendations

The November 2016 Uber tribunal ruling, resulting in Uber drivers being successful in their bid to be awarded employee rights, means it is more important than ever to ensure that employers have considered the employment status of their workers.

The ruling comes as HMRC announces the launch of a specialist unit to investigate companies who opt out of giving workers employment protection, by using agency workers or calling them self-employed. The same team will also police the recent change in the rules (IR35) on personal service companies used in the public sector.

Incorrect classification can result in the employer or contractor being held accountable for any tax and/or NICs not deducted and paid (plus interest and penalties of up to 100% of the outstanding liabilities).

We recommend that businesses that depend on a self-employed workforce (e.g. with the use of self-employed workers, consultants and personal service companies) should review their arrangements, to ensure they are robust and can withstand scrutiny. This type of 'health check' on worker arrangements should help identify areas of risk based on current HMRC reviews.

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