



EMPLOYEE OR SELF EMPLOYED? - HMRC'S APPROACH TO EMPLOYMENT STATUS

The HMRC will be looking at the following factors when ascertaining whether to categorise an individual as an employee or self employed:

A. Factors indicating employed status

- 1. Mutual obligations:** where the payer is under an obligation to provide the worker with regular work and the worker is under an obligation to make themselves available to do the work.
- 2. Contract of service:** where the worker is bound by the terms of their contract to be available to perform general services (usually for an indefinite period) rather than a specific task to be completed within a specified time.
- 3. Remuneration package:** an employed person is more likely to be paid a fixed wage or salary on a regular payment date, irrespective of performance targets. They will also normally participate in the company pay, benefits and pension schemes on the same terms as other employees, and be entitled to paid holiday, sick leave and notice
- 4. Performance bonuses:** bonuses are traditionally considered by HMRC to suggest employed status, although it is quite possible in principle for self-employed persons to have bonus arrangements.
- 5. Exclusivity of service to one organisation:** an employed person will not normally be free to work for other employers whilst under contract, at least without the express permission of their employer.
- 6. Employer's equipment and facilities:** the employer will normally provide an employed person with the facilities and equipment required for him to do their job.
- 7. Integration into the employer's business:** an employed person will normally be recognisable as part of the organisation, that is, their name may appear on the internal telephone directory and e-mail address list, they may wear the company uniform, drive a company vehicle or carry a company business card. A person is more likely to be an employee if they work alongside other employees doing the same job in similar circumstances.
- 8. Reimbursed expenses:** an employed person will normally reclaim from their employer all personal expenses they incur in the performance of their duties. A self-employed person would more normally include their expenses, or at least their "overhead" expenses, in the fee negotiated at the beginning of the assignment. However, it is quite normal for self-employed people to re-charge out-of-pocket expenses to their customers in addition to their flat fee.

B. Factors indicating self-employed status

1. **Financial risk:** a self-employed person will normally risk their own capital in their business and will be personally responsible for any losses arising from their work.
2. **Commission-only work:** a person who receives no flat fee and whose earnings are based on commissions (e.g. commission-only salesmen) is more likely to be classified as self-employed.
3. **Own equipment:** a self-employed person will normally provide their own tools and equipment.
4. **Right of substitution:** a self-employed person may have their own partners and employees who they can send in their place to undertake the work in their absence. An employee would not be able to send a substitute to work on their behalf.
5. **Established business status:** a self-employed person may already have established the taxation status of their business with HMRC and where this is so, it is more likely that any particular engagement undertaken in carrying out that business will be accepted to be part of that business, even though in other circumstances, that engagement might be construed as an employment.
6. **Freedom to choose engagements:** a self-employed person will normally be free to provide their services to whichever customers they choose without operating exclusively for one company.
7. **Control:** a self-employed person will normally use their professional expertise to determine how, where and when they conduct their work, without being under the direct supervision of the payer.
8. **Contract for services:** a self-employed person will normally have a contract stipulating a specific service to be delivered within a set time frame. Payment will normally depend on that service being delivered on time and to a satisfactory standard.
9. **Remedial work:** a self-employed person will normally be required to correct unsatisfactory work in their own time and at their own expense. They will not normally be paid overtime.

C. Tax treatment of employees and the self-employed

1. PAYE?

Any person making a payment to another in return for work must operate PAYE and Class 1 National Insurance Contributions (NICs) if the worker is his employee. If the worker is self-employed, the payer need not operate PAYE or NICs. *The payer must therefore accept responsibility for determining the employment status of the worker before any payment is made.* The payer may request a formal ruling from their local tax office. If the parties do not agree with a ruling by HMRC either of them may appeal to the Appeal Commissioners.

If the payer fails to deduct PAYE and NICs when appropriate, *HMRC will normally seek recovery of the tax and NICs which should have been paid from the payer*, going back six years, together with interest and possibly penalties.

If HMRC subsequently challenges an employer's decision not to deduct PAYE/NICs, the employer may be relieved of liability for payment of the tax if it can satisfy HMRC that it made an innocent error and took reasonable care to apply the PAYE regulations. Even if the employer fails in this and is required to pay the tax, the care with which it considered the question of employment status at the outset may have a bearing on any penalty sought by HMRC. HMRC used to give employers credit for any tax paid by an individual on a self-employed basis in circumstances where they have been incorrectly treated as self-employed. This practice is now on its way out and employers should assume that they will no longer be given credit for tax paid by employees as self employed.

Tax treatment of employee	Tax treatment of self-employed
taxed at source on earnings under the PAYE scheme	responsible for accounting to HMRC for own income tax and national insurance contributions
National insurance contributions (NICs) deducted at source	Needs to account to HMRC for VAT, if earnings reach the required level
Employers' NICs paid by employer into the NI scheme	

2. IR35

Where a consultant provides their services to their clients through a service company (or partnership) the IR35 rules may apply.

Schedule 12 of the Finance Act 2000 ("Provision of services through an intermediary") and the Social Security Contributions (Intermediaries) Regulations (SI 2000/727) (together the IR35 rules) came into effect on 6 April 2000. Prior to 6 April 2000, it was possible for individuals to provide their services to clients through intermediaries, such as personal service companies, in circumstances where, if it were not for the personal service company, the individual would be an employee of the client for tax purposes.

The use of intermediaries in this way allowed the client to make payments to the personal service company rather than the individual, without deducting PAYE or NICs. The individual could then take money out of the service company in the form of dividends instead of salary. Dividends are not liable to NICs so the individual paid less in NICs than either a conventional employee or a self-employed person. There were also tax advantages to these arrangements.

The IR35 rules were introduced to enable HMRC to look beyond the tripartite arrangement to the reality of the particular situation and assess whether there is an employment relationship in fact. The rules apply if there is a "relevant engagement", that is, where:

- a) A worker provides their services to a client which is a business;
- b) Through an intermediary;

- c) In circumstances where, if the arrangements had been directly with the client and not the intermediary, the worker would have been treated as an employee of the client for tax purposes.

If a relevant engagement is found to exist, income paid to the service company by the client will be deemed to have been paid to the individual providing the services and income tax and NICs must be deducted under the PAYE system by the service company. The IR35 rules do not affect the client receiving the services who will continue to pay the service company (or partnership) in the usual way (together with VAT, if appropriate).

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