

Status of Contractors



Meet the panel



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Introduction

With the economy seeing some kind of recovery, employers are looking more carefully at the contractual relationships with their people. Once the decision has been made to take on additional resource, the often harder decision of “how” to engage workers follows. Employers are choosing from Employed Status (part time, full time, term time, temporary, zero hours), Agency Workers which have been around for some time and genuine self-employed contractors. Since the recession we have seen an increasing number of contractors available where employers are choosing to work with them to complement their existing workforce. This month, your experts at Qdos Consulting are joined by our tax experts at Qdos Status Services Ltd, in order to discuss the dangers, merits and potential pitfalls of working with contractors.

What different types of employment status are there?

Kate: Well, you have Sole Traders, Agency Workers, and of course employees. You also have IR35, which is solely for Limited Company Contractors; these are known as a Personal Service Company (PSC).

What is IR35?

Kate: IR35 is a piece of legislation which aims to combat the avoidance of paying PAYE income tax and NICs by an individual who would be treated as an employee were it not for the fact they provide their services via their own PSC. It was introduced to stop workers leaving employment and returning in the same role as a contractor through

their own limited company for tax efficiency purposes. If HMRC investigate a contractor and decide that they are ‘caught’ by IR35, and are in effect an ‘employee’ they will calculate a deemed payment, treating all income received as salary and demanding all tax and national insurance contributions on payments originally paid out as dividends. This could also impact on the savings that the “employer” made on National Insurance and tax that might have otherwise have been paid.

Obviously, there are a huge amount of contractors who are genuinely independent and they face the same struggle to prove this fact to HMRC. But, unfortunately, there are a lot of grey areas that build up IR35. There are a number of tests to determine whether or not a contractor will be in or outside IR35.

What are the tests?

Linda: There are three main tests but ten in total. Arguably, the most important test is the right of substitution. This means that in the event of the contractor being unable to carry out the work, they would be able to send an adequate individual in their place. This is because a Limited Company is being engaged for their services, and not the individual carrying out the work.

Kate: There are also the Control and Mutuality of Obligation tests. The Control test will seek to determine the “how”, “when” and “where” the work is carried out. An independent, professional contractor should not be subject to any degree of

control by a company. The Mutuality of Obligation test looks at the right of the company to not offer ongoing work or by contrast, whether a contractor can refuse the work without facing a detriment.

Linda: There are seven other tests, including, Provision of Equipment, Financial Risk, Basis of Payment, Exclusive Service, Part and Parcel of the Organisation, Intention of the Parties and Business-like Trading.

The definition of an employee is one that is engaged under a Contract of Employment, how can we define the difference between an employee and a contractor?

Linda: Well, it’s based on tax cases, which is why there is not a good definition. The right of substitution is likely to be seen as the key test.

What are the advantages for individuals operating through a Limited Company?

Kate: Primarily, it will be the advantage of paying much less tax, which has to be balanced with the costs involved in running their own business. Obviously, there are always “pros” and “cons” of being a contractor – the flexibility of who they work for and when, but the disadvantage of job security and additional administration etc...

Andrew: There are additional liabilities too, if a contractor provides their services through a Limited Company they can put the liability through their Limited Company, however, if they are a Sole Trader, they have the ultimate responsibility should anything go wrong.

Linda: But the risk for being Limited is that if the contractor were to be investigated by HMRC and ultimately deemed to be acting like an employee, or “inside” of IR35, it would be their company liable for the tax, interest, penalties and NIC and they can be fined 100% of the tax due.

Why would our clients look to work with contractors over an agency worker?

Kate: Well once it is established that the project is of a temporary nature, you could of course employ a temporary employee and, for low skilled work, that and high street agencies are still the preferred choice.

However, certain professions, jobs, tasks that are carried out by highly skilled people, which are often not available through an agency. In addition, typically employers are avoiding agency fees and depending on the time that the contractor would be required, they would be captured by the Agency Workers Regulations.



Where does the health and safety responsibility lie?

Andrew: If you are self-employed, at the moment, you are ultimately responsible for your own health and safety, although certain aspects of the legislation are changing. There is a bit of a grey area



too; once a company has at least one employee, they are obliged to have Compulsory Liability Insurance, in these cases, it is arguable, that the health and safety responsibility of all people working for them rests with them, regardless of their employment status.

What is the key risk to employers when engaging with contractors?

Linda: If an individual is operating via their own Limited Company, even if they are “caught”, the client will not have any liability, the contract should be between the company engaging with the services and the Contractor’s Limited Company. If the contractor is then deemed to be inside of IR35, then they will be liable for any tax and National Insurance due.

The major risk to employers, is engaging with contractors who operate as Sole Traders. If they are deemed to be inside of IR35, ultimately, this could result in a challenge by the contractor to the employer claiming to be employed by them. This could result in demands for underpayment in tax and National Insurance. Additionally, this could lead to challenges for Employment Rights, making it difficult to dismiss along with claims for outstanding holiday pay.

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What can employers do to ensure that the contractors who they engage with are compliant?

Kate: Having a strong contract is important, as is the reality of working practices. Holding business insurance will also help. “We had an interesting case where the client’s contract made a requirement for Professional Indemnity Insurance (PII), throughout the HMRC investigation it became apparent that the contractor did not have business insurance. HMRC took the stance of “if you have not got PII and it’s stated in your contract that you should have it, what else in your contract isn’t true?” This led HMRC to question the validity of the contract and they pursued a much deeper investigation.

In any enquiry HMRC will always go to the end client to ask the questions, regardless of whether the contractor is through an

agency or not. They will ask questions such as “Do they have a line manager?” – looking at elements of control. They will look to see if the contractor is integrated to the organisation by looking at whether they attend training sessions, invited to Christmas functions etc... of course, HMRC are unlikely to view just one issue and will take other things into account too for an opinion.

Toni: Bearing in mind that our clients are employers, what is the best advice that you can offer to protect their business when using contractors?

Kate: Ideally, they need a strong, compliant Contract for Services that work alongside a Statement of Working Practices signed by both the client and the contractor.



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