

# **PAYE: PROBLEMS WITH CASUAL WORKERS AND THE SELF-EMPLOYED**

## **INTRODUCTION**

In recent years, the Inland Revenue and the Contributions Agency have been paying special attention to the correct classification of so-called “casual” employees and “self-employed” workers. The advent of the IR35 rules on personal service companies, together with the existing Construction Industry Tax Deduction Scheme, means that the Inland Revenue now have a considerable battery of measures to employ if they believe that payments have been made without due regard to the PAYE system.

Employers and their staff need to know what the expressions “casual employees” and “self-employed” mean in connection with the PAYE system. The incorrect classification of workers frequently results in substantial arrears of PAYE and National Insurance Contributions (NICs) being demanded. Interest and sometimes penalties may also be sought. The impact on expense claims can also be significant, since – as a general principle – the treatment of expenses is more favourable for self-employed people than for employees.

## **PURPOSE OF THIS MEMORANDUM**

The purpose of this Memorandum is to highlight the main issues so as to forewarn unsuspecting employers of pitfalls to be avoided. The Revenue makes no distinction between small and large employers when investigating this area. A small employer facing an unexpected bill for, say, six years' arrears of tax and NICs in respect of only one worker will often suffer a significant financial problem. Where several workers are re-classified as employees the viability of the employer's business may be threatened.

Clients' attention is therefore drawn to the following notes. However, these notes are not intended to be exhaustive and are merely indicative of the issues to be addressed. As always, please consult us for advice if you are in any doubt.

## **CASUAL EMPLOYEES**

Problems here usually arise from the fact that the term “casual employee” has a different meaning within certain trades or industries compared to the Inland Revenue's definition.

The PAYE position is clearly spelt out in the Employer's Guide. As far as the Revenue is concerned, a casual employee is someone taken on for no more than one week and not taken on again in the same tax year. Thus, if someone is taken on for eight days, he (or she) cannot be regarded as a casual employee. Likewise, if a worker is employed for five days in March 2002 having worked for one day in May 2001, he (or she) cannot be regarded as

a casual employee. The PAYE system – according to the Employer’s Guide – must be operated.

Special rules apply in certain circumstances. For example:-

- **Agency workers.** If you use the services of a worker supplied by an agency, the agency will usually be responsible for operating PAYE and NICs. However, if an agency worker agrees to work directly for you, you will normally be responsible for PAYE and NICs.
- **Migrant workers.** If a non-resident is working for you in this country, you will usually need to apply PAYE and NICs procedures. However, this requirement may not apply if the person will not be working under your day-to-day control or management; in this case, it will be necessary to agree the appropriate position with your Tax Office.
- **Farmers.** There are special rules for “harvest casuals”, gang-masters and contractors. It will not be necessary to operate PAYE and NICs for a harvest casual who works for you for no more than two weeks, as long as he (or she) is not a member of your family and has not previously worked for you for more than one day in the same tax year. If you use a gang-master or a contractor, who is not one of your own regular workers, to carry out a specific assignment, the gang-master or contractor will usually be responsible for operating PAYE and NICs, but you must retain records of payments, since the Tax Office may ask to see these in due course.

In addition, employers sometimes assume incorrectly that, because an employee is properly called a casual employee, PAYE need not be applied. The Employer’s Guide makes it quite clear that, if the wages payment equals or exceeds the NIC weekly lower earnings limit (i.e. £72.00 for 2001/2002 and £75.00 for 2002/2003), a deduction working sheet must be prepared and NIC deducted accordingly. In addition, if the payment exceeds the PAYE threshold (i.e. £87.00 in 2001/2002 and £89.00 in 2002/2003) either a code BR or the emergency code should be applied and tax deducted accordingly. These rules will be applied to the letter by the Inland Revenue - even where any breach of these rules was arguably apparent at the time of previous PAYE inspections and no questions were raised. Clients in any doubt about these rules should contact us for guidance.

### **WORKERS: “SELF-EMPLOYED” OR “EMPLOYED”?**

Difficulties here are often caused by the mistaken belief that it is up to the employer to decide whether or not a worker should be engaged on a self-employed basis or as an employee. The position in law is that the terms and conditions of the contract with each worker determine whether he or she is self-employed or an employee. The issues are complex and there are many ‘grey areas’ but the following gives an indication of the matters that are often addressed during a PAYE inspection by the Revenue. No one point listed below is likely to be conclusive in isolation and more often than not a number of factors determine the outcome.

## **Some characteristics indicative of “employment”**

The worker

- is paid by the hour, day, etc. and provides nothing but his or her own labour (i.e. he or she does not provide materials, equipment, etc.) - especially if he or she is expected to work a regular number of hours each week
- has no risk of financial loss (other than the risk of not being paid by the person for whom he or she is working)
- has no identifiable business structure or organisation and receives a fixed remuneration
- is working under the contractor’s control or supervision
- has agreed not to work for any other person
- is closely integrated with and identified by customers as being part of the staff. Typically he or she may have an allocated office, be described by name in company literature as part of the workforce, etc.
- has a contract which is very similar to that of other individuals working in the business and accepted as being employees.

## **Some characteristics indicative of “self-employment”**

In the following circumstances the worker may have a case for arguing he or she is self-employed.

The worker

- has some say on the type of work accepted, and how, where and when the work is to be done. The worker will usually possess the necessary skills and will not require any training to perform the tasks
- is not paid for work not done, has no holiday pay, pension scheme, benefits and provides their own transport
- can arrange, at his or her own expense, for someone else (suitably experienced) to carry out the work he or she has agreed to undertake
- is paid per assignment undertaken, regardless of the time it takes

- provides plant, etc, used in carrying out the work
- does not rely on a single source for his or her income and actively seeks other work
- is liable for negligence, late completion, late delivery, etc
- is registered for VAT, has business stationery, a business bank account and is paid only on invoice.

### **Personal Service Companies**

These have been used by self-employed individuals to attempt to disguise their true “employed” relationship with clients to avoid income tax and NIC liabilities. Recent Inland Revenue rules, first mooted in their Press Release IR35, effectively eliminate this practice unless an appropriate relationship exists between the client and the personal service company representing the self-employed individual. The relationship provisions are complex and beyond the scope of this Memorandum to explore. However, if you promote your services via such a company, we strongly recommend that an immediate review of your position takes place.

### **GUIDANCE AVAILABLE**

None of the points listed above is conclusive, and professional advice may well be necessary to weigh up the various characteristics and help to determine the correct status of the worker.

The Inland Revenue has published a free leaflet IR148 entitled “Are Your Workers Employed or Self-Employed?” which focuses on the construction industry and is available from your Tax Office. Substantial reclassification has in fact taken place within the construction industry in respect of labour only sub-contractors following negotiations with that industry. However, as already indicated, the question is complex and IR148 is only intended to alert taxpayers to these complexities. As such, it should be regarded as being no more than a useful introduction to the issues.

### **THE OFFICIAL APPROACH?**

In practice, the approach of both the Inland Revenue and the Contributions Agency in cases of doubt is to take the view that “he’s an employee!”. Therefore, careful consideration of the facts of each case is required before conclusions are reached. It should be noted that the fact that a particular worker’s status (or the status of a group of workers) has not previously been challenged does not necessarily mean that the status has been formally accepted by the Revenue. It may be challenged during the next PAYE inspection.

In recent years the arrears of tax and NICs attributable to the reclassification of workers incorrectly treated as self-employed has run into millions of pounds. Usually, it is the

unfortunate employer who has to foot the bill. We are happy to advise clients on the status of any worker currently regarded as self-employed or the current status of a personal service company. Forewarned is forearmed!

### **FOR GENERAL INFORMATION ONLY**

Please note that this Memorandum is not intended to give specific technical advice and it should not be construed as doing so. It is designed merely to alert clients to some of the relevant issues and is not intended to give exhaustive coverage of the topic.

Professional advice should always be sought before action is either taken or refrained from as a result of information contained herein.