

EMPLOYEE OR INDEPENDENT CONTRACTOR

Distinction

A key distinction in employment law is between a "contract for services" and an employment contract. A contract for services is provided by an independent contractor i.e. someone in business on his own account. An employee is somebody who works under the terms of an employment contract.

There can sometimes be a thin dividing line between a contractor and an employee. The law has always been, that if the relationship is in substance and in practice an employee/employer relationship, then it is deemed to be so, no matter what the parties label or call themselves.

Being an "employee" carries certain consequences particularly for the employer. Employees are entitled to a range of protection rights. The employer is obliged to deduct PAYE and National Insurance Contributions from payments to an employee. The failure to properly identify a person as an employee who labels wrongly himself as an independent contractor, could cause significant liability for the employer if the matter is reviewed by HMRC at a future date.

There are a number of key tests to determine whether somebody is or is not an employee. Control is an important element. Generally an employee can be instructed as to which tasks to perform and how to perform them. The degree of integration of a person as part of the organisation is a significant factor. An employee is generally obliged to carry out the work personally. In contrast, an independent contractor may be able to substitute someone else to do the work.

Economic reality is an important factor. An independent contractor is in business on his own account and bears the financial risks (and rewards) from his own sound management of the task.

The Courts and other bodies undertake a composite test, taking all of the above factors into account. The level of independence is critical. Having a final say in how the business is run, risking ones own money, providing his own equipment and the

ability to substitute, are key indicators of a contract for services i.e. the person is an independent contractor.

In a borderline case, the question as to whether an individual is an employee or independent contractor may only be ultimately decided in some formal body such as the Revenue, an employment tribunal or by the Courts in the event of a dispute.

An individual who is self-employed must inform the Revenue himself and has his own independent tax obligations. He will generally have to charge VAT on services provided.

Special Tax Rules

Directors of limited companies are classed as office holders. The earnings from an office are automatically chargeable to tax as employment income and there is also liability for Class National Insurance contributions. Executive directors will nearly always be employees. Non-executive directors may be employees of the company or self-employed under a contract for service, depending on the circumstances, terms and conditions.

In certain sectors, there is an obligation to deduct tax on payments to sub-contractors even if they are not employees. There is a special tax scheme for self-employed contractors and sub-contractors in the construction industry. This is equivalent to "relevant contracts tax" in Ireland.

There are special rules in relation to managed service companies, which have no counterpart in Ireland. A managed service company is a form of personal services company. Payments received by individuals who provide a service to an MSC are subject to PAYE and NIC. Special legislation ensures that individuals operating a managed service company, pay tax and NIC at the same rate as employees. PAYE and NIC contributions are recoverable from the MSCs. They can be assessed on certain third parties and recovered from certain third parties e.g. directors of the MSC and certain associates.

This Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances.

This Guide should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances.

While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in this Guide. The reader should rely only on specific legal or taxation advice.

© Lavelle Coleman 2009