

Taxing Independents *in the* **Charity Sector**

A Guide to the taxation of people working in the organisation, ON and OFF the payroll.

This Guide is aimed at employers who commission work for their organisation and who then have to decide whether the worker/supplier should be on or off the payroll – with all the implications of employment status and related taxation issues. The reality can be different to the way it looks or is supposed to be at the outset. Finishing up with employees you thought you didn't have can take up a lot of management time, create much anguish and prove to be very expensive.

This Guide is offered for general guidance only and professional advice should be sought in each individual case. The views expressed in and the content of this Note are offered in this context. Much is changing continuously and they should not be relied upon without taking formal legal and accounting advice. **No responsibility is accepted for any loss or damage arising out of reliance on the contents of this Guide.**

Please note that this Guide was prepared in November 2006 and represents the position as the authors understand it at that time.

Bates Wells & Braithwaite



Bill Lewis

BWB is widely regarded as one of the leading charity and not for profit law firms in the country. They are recognised as such by their clients and by the two leading guides to the legal profession – the Legal 500 and the Chambers Guide.

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Charles Russam

This much needed Guide has been created by Bill Lewis of lawyers Bates Wells & Braithwaite and Charles Russam of Russam GMS Ltd, a leading Interim Management Provider specialising in the Charity and Not-for-Profit sector.

What's all the fuss about?

This is a minefield! And it is getting worse.

The distinction between whether a person is an employee or self employed is not clear for tax purposes and also differs in legal definition terms, clouding issues of legal rights, etc. At one end of the scale is the employee who has been employed full time by the business for years and at the other end is, for example, the 24 hour emergency plumber who calls round only when needed and is self employed. However, modern, flexible working practices mean that the position is not clear for many individuals engaged by Charities, particularly as many employment tax laws originated in the Victorian age when working life was somewhat different than today!

It is made worse because the rules/law – EC and UK - are continuously changing; interpretations, particularly by Her Majesty's Revenue & Customs (HMRC), often seem to be subjective and even arbitrary and differ from source to source and case law is inconsistent and sometimes contradictory.

However, today's changing working practices mean that flexibility is becoming more important and it is also very important to get the structures and arrangements right.

These are the risks:-

Workers who present themselves as Independents to the organisation may in fact also turn out to be permanent workers in tax terms – at the decision of HMRC, in the person of their local Tax Inspector/office – different ones sometimes take different views. See below re costs/penalties, etc.

Workers who present themselves as Independents to the organisation may in fact also turn out to be permanent workers in legal terms. The risk here is around the costs of permanent employees.

You can ask HMRC offices for advice and judgements - including through their online ESI (Employment Status Indicator) but their advice is always cautious and virtually always aimed at collecting tax.

You can ask the lawyers and auditors for their advice. Firstly, you need to find the specific individuals who really know about this area and identifying these individuals is not always easy. Once you have done this, you need to bear in mind that their

advice is always cautious. Some risk needs to be realistically considered.

Descriptions of the individual's "vehicle" need to be considered carefully. Sole trader, limited company, limited liability partnership, ordinary partnership, umbrella company all run the risk of actually being different to what they seem – what is the reality and what are the judgements of other parties – e.g. HMRC?

Individuals trading through limited companies (PSVs – Personal Service Companies) can sometimes be deemed in legal terms (but not necessarily in tax terms other than through IR35) as employees of the organisation. (See *Muscat v Cable & Wireless*).

Sole trader consultants are often quite difficult to assess in tax and legal terms. Just claiming to be a self-employed consultant does not mean they are and HMRC can take the view that the organisation acted incorrectly in not making PAYE deductions with appropriate penalties and the individual can change his/her mind – even retrospectively.

Broadly, there are three ways in which a person may work with an organisation:-

An Employee

The individual is either employed directly or by a temporary worker agency which supplies the worker. Either way the employee pays tax under PAYE and employee National Insurance Contributions (NIC) at 11% basic rate and 1% higher rate on their earnings. The agency/employer also incurs an additional 12.8% cost for employer's NIC.

The employee is unable to claim from the employer tax free the cost of home to workplace travel, and similarly cannot claim a tax allowance for the cost of the travel.

Self Employed Consultant

The individual is engaged as an independent consultant by the business. The worker invoices the business and is paid directly for their services without deductions. The worker can be paid additional sums to cover the cost of home/work travel, should the business so wish. Various expenses can be claimed against the consultant's tax bill by the consultant - such as the cost of running a home office, and travel between home and the workplace. Tax rates are the same as for an employee, but NIC rates are 8% for the basic rate and 1% for the higher rate. The self-employed consultant does not have to pay Employer's NIC. So, overall, a self employed worker pays less tax and NIC than an employee. If the self employed consultant's income exceeds £61,000 per year (2006/07) then the worker must charge VAT at 17.5% on top of their fees.

Consultants & Interim Staff Who Supply Their Services Through Limited Companies

This is the safest route for any business. The contractual arrangement is between the organisation and the limited company for the limited company to provide services to the business. The company issues invoices and is paid by the business. The consultant supplied by the company must not be paid directly by the business.

In these circumstances the organisation cannot be charged PAYE for the consultant's services. The responsibility for the payment of PAYE taxes in connection with the consultant rests with the Personal Service Company.

The consultant sets up a small limited company (which can cost less than £100 to set up). This Personal Service Company (PSV) is engaged by the organisation to supply services. The company must issue invoices for the supply of the worker's services. The worker can then be remunerated partly by a small salary of at least the minimum wage (£5.35 per hour from October 2006) which is subject to deduction of tax and NIC under PAYE and subject to Employer's NIC, and partly through dividends which are not liable to NIC and have a top tax rate of 32.5% as opposed to 40% for general income.

However, if the worker is carrying out services in a manner akin to an employee of the business then under the IR35 tax rules (see following comments) the PSV must pay 95% of fees invoiced for the worker to the worker under deduction of tax and NIC under PAYE, leaving only 5% to cover administration costs for the company and no room to pay NIC saving dividends. These rules affect only the worker and their tax position and apply to each individual project/assignment – they do not affect the "Employer".

Again, if the company's income exceeds £61,000 per year (2006/07) then the company must charge VAT at 17.5% on top of its fees.

The Business's Perspective An Employee

This is the most tax expensive way of engaging temporary staff but also the most conventional and straight forward. The staff must be paid under deduction of tax and NIC, and the business must pay 12.8% NIC on top. The organisation will also grant the worker employment rights, entitling the worker to holidays, sick pay, maternity pay, pensions etc including wrongful/unfair dismissal issues. Similar costs apply whether the worker is paid directly by the organisation or is paid through a supplying staff agency but the position of the agency is slightly different from that of the ultimate client/employer.

Any worker who is engaged direct as an "interim" or "temporary" member of staff, either full-time or part-time, must gen-

erally be treated as an employee and paid under PAYE, whether paid through the business's payroll or whether supplied via an agency and paid by that agency

Self Employed Consultant

This can be the cheapest way for an organisation to engage a consultant as the workers are responsible for their own tax and NIC. However, if the organisation wrongly treats as self employed a worker who should have been paid as an employee under deduction of PAYE then this can be a very expensive route. HMRC, if they question the arrangement and find the worker should have been paid as an employee, will deem all sums paid to the worker as net of PAYE payments. They will therefore gross the payments up for tax and NIC and apply employer's NIC to the total. Typically, this will increase the cost of a consultant who normally costs £200 per day to £336 per day, or £460 per day for higher rate taxpayers. On top of this HMRC can charge interest on any taxes regarded as paid late, and can charge tax geared penalties on top up to a maximum of 100% of the tax fine levied.

Consultants supplied through agencies must always be paid under PAYE; the agency cannot pay them gross, unless they trade through Personal Service Companies (PSVs).

Broadly, for an employment relationship to exist, the answer must be YES to these three questions:-

- Is there a requirement of actual "personal service" from the named Individual"?
- Is there "mutuality of obligation"? (The Individual must do the work and the Employer must provide the work and pay for it.)
- Is the worker "under the control" of the Employer?

Arriving at the answers to these three questions is where difficulties often arise.

HMRC publish on their website www.hmrc.gov.uk a leaflet "Employed or Self Employed?" which gives basic guidance on employment and self employment.

This explains that if the answer is yes to all the following questions the worker will probably be an employee for tax purposes.

- Must the worker do the work themselves?
- Can someone tell the worker at any time what to do, where to carry out the work, or when and how to do it?
- Does the worker work a set amount of hours?
- Can someone move the worker from task to task?
- Is the worker paid by the hour/week/month?

- Can the worker be paid overtime or bonuses?

Whereas if the answer is yes to the following questions the worker will usually be self employed.

- Can the worker hire someone to do the work for them or engage helpers at their own expense?
- Does the worker decide what work they will do, how and when to do the work and where to provide the services?
- Does the worker risk their own money?
- Does the worker provide substantial equipment to enable them to do their job?
- Does the worker carry out the work for a fixed price irrespective of how long it takes to complete the work?

HMRC often argue otherwise, but the Courts have indicated that if any one of the following are present then the worker is almost certainly self employed:

- The worker can hire someone to do their work or engage helpers at their own expense.
- The worker cannot be told at any time what to do, where to carry out the work, or when and how to do it.
- The engager is not obliged to offer work to the worker, and the worker can choose not to accept or do work offered to them.

These tests are clearly very subjective and can be challenged. Individuals tend to back down – or never even try – but businesses with deeper pockets can fight – it is all a question of judgement, weighing costs and time against outcomes.

If these are not present, the other tests take on more importance in determining the overall employed/self employed position.

HMRC also have on their website an “Employment Status Indicator” (ESI) – a computerised questionnaire which can help you determine whether a worker can be treated as employed or self employed. HMRC have said they will abide by decisions given under the ESI provided it is honestly completed. So if the ESI deems a worker to be self employed you should be on safe ground.

Please note the ESI will only give an answer in straightforward cases. Where the circumstances are complicated you will either have to write to HMRC for a status ruling, or seek professional advice.

Some consultants will tell businesses that there are “special rules” for their sector of work which means they can always be treated as self employed. There are no such special arrangements.

Contracts and Agreements

It is very important to get the contractual arrangements right. Your lawyer, accountant, Interim Management/ Temporary Worker Provider may be able to provide advice.

Bates Wells & Braithwaite have an employment law team who can give advice and draft general and bespoke contracts between workers and charities. www.bateswells.co.uk, 020 7551 7777

Also available to offer advice is The Interim Management Association – IMA www.interimmanagement.uk.com a division of The Recruitment & Employment Confederation - REC www.rec.uk.com which has a range of standard/ model Contracts. Also, The Professional Contractors Group www.PCG.org.uk also offers much important information and standard/ model contracts. These organisations offer their services to members and non-members by special arrangement.

We recommend that whenever a charity engages a self employed consultant they include a clause in the contract under which the consultant indemnifies the charity against PAYE taxes and fines. However it is best not to get into this situation in the first place due to the difficulties of getting money out of someone who does not want to pay or may not be able to pay – and who may or may not be covered by Professional Indemnity Insurance.

Remember, each engagement must be judged on its merits. Just because a worker is self employed with other clients or has been self employed in the past does not mean that you can treat them as self employed for the work they carry out for you.

If you have any queries or would like to talk about any issues arising, please get in touch with Bill Lewis of Bates Wells & Braithwaite or Charles Russam of Russam GMS Ltd.

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