

Contractors' Questions: Why's employee tax due on self-employment?

(Article taken from Contractor UK Limited where Graham Jenner, a Director of No Palaver answered contractors' questions)

Contractor's Question: My partner is self-employed working through an employment agency. This agency claims he is a self-employed person, but working under 'supervision' and because of this supervision, they have put him on the payroll and deduct National Insurance (NI) and tax from his payments.

But at the same time, he doesn't have the rights of an employee, just the obligations of one. What are we not understanding - can they really claim he is a self-employed person, but on his payslip it's a different matter?

Expert's Answer: This is an interesting question, as the reason the agency has treated your partner as employed for payroll purposes is due to amended legislation that was partly introduced to stop workers from being denied their employment rights.

However, the amendments only dealt with the question of tax avoidance. As a result, a temporary agency worker who is self-employed in law can indeed be taxed like an employee, with, as you say, none of the rights of an employee.

The so-called Agencies legislation had, for many years, required an agency hiring out temporary workers to tax them as though they were their employee. Due to the need to account for both Employee's and Employer's NI, the cost of treating someone as an employee, as opposed to self-employed, is significantly higher.

To reduce their costs, some agencies had contracts with workers which sought to get around the above requirement. This often involved introducing a third party. The practice became so widespread that the government was forced to amend the legislation from 5th April 2014. The changes mean that, where an agency (or any other intermediary) supplies a temporary worker who is subject to, or to a right of, supervision, direction or control, they must treat the remuneration as though it were employment income arising from an employment with the agency.

Agency workers are generally not employees but instead are "workers" who enjoy considerably less employment rights than an employee.

It depends on which sector your partner operates in as to the financial effect of this legislation. In a sector where the end-client is used to workers being employees, the cost of Employer's NI is probably taken account of within the rate charged by the agency.

However, in a sector with many self-employed workers, such as construction, the agency will struggle to charge the end-client a rate sufficient to cover the Employer's NI that they have to account for. The agencies' margin is not going to be high enough for them to absorb the Employer's NI and so the effective rate offered to the worker is lower.

Market rates will eventually find a sensible level. For now though, contractors need to be aware before taking on a contract how they are going to be treated for tax purposes and perhaps request an indication of their take-home pay.