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Construction - August 2009

What's in a name?

Employee or self-employed, does it matter? Definitely, and in the 2009 Budget, the Government announced its intention to address the ongoing problem of false self-employment in the construction industry. Previous attempts to resolve the issue, for example, through compliance measures have been unsuccessful. The Government is of the view that introducing legislation is the best way forward and it recently issued a consultation paper on its proposals.

What is false self-employment?

False self-employment occurs where workers are treated as self-employed for income tax and National Insurance (NICs) purposes even though the way in which they carry out their work on a day-to-day basis is more indicative of an employment relationship.

Clearly, within all industries and sectors, certain services will be provided on a self-employed basis. Within the construction industry however, there is a much higher proportion of self-employed workers than in other sectors. According to the European Labour Force Survey 2007, 34% of workers in the construction industry are self-employed compared to only 11% in other sectors. Further, the estimated number of individuals working under employment terms but in fact being presented as self-employed is around 300,000.

What are the consequences of false self-employment?

Primarily, the consequences are financial. There is a difference in the tax and NICs treatment between the self-employed and employed. Employers' NICs are due on payments to employees but not on payments to those engaged on a self-employed basis. In addition, the self-employed pay a lower rate of NICs than the employed. There is a financial incentive therefore for

workers and those who engage them to portray income as income from self-employment rather than employment income in order to reduce tax and NICs liabilities. The very many businesses who are fully compliant and who pay the appropriate amount of tax and NICs are disadvantaged commercially by those businesses who do not properly engage their workers as employees. In relation to the Exchequer, it is estimated that as a result of false self-employment and less tax and NICs being paid its loss is in the region of £350 million a year.

Whilst on the face of it there is a financial advantage for the individual to be classified self-employed rather than as an employee, this could well be to their detriment in the long-term as it affects their entitlement to state benefits such as job seekers allowance. Not only this, but many individuals are being deprived of a range of employment law rights because of their status as self-employed when in reality there may be an employment relationship.

What is the Government proposing?

The Government is proposing to apply a set of specific criteria to the engagement of workers. What this will mean is that those who are receiving payments for engagements that in reality amount to employment will then have the correct amount of income tax and NICs applied to those payments. Where a person ("the engager") whose main business involves the carrying out or commissioning of "construction operations" uses the services of a worker to carry out such operations, the payment received in respect of those services would be deemed to be employment income **unless** the worker fulfils one of following three statutory criteria:

- the provision of plant and equipment – that a person provides the plant and equipment required for the job they have been engaged to carry out excluding the tools of the trade which is normal and traditional for the job;
- the provision of all materials – that a person provides all materials required to complete a job; or

- the provision of other workers – that a person provides other workers to carry out operations under the contract and is responsible for paying them.

A worker will have to meet one or more of these criteria in order not to be deemed to be in receipt of employment income. It is the Government's view that these criteria will generally establish that an individual is genuinely carrying on a business on their own account by:

- investing in the plant and equipment necessary to carry out the contract;
- sourcing and supplying the materials for the contract; or
- engaging additional labour for fulfilment of the contract and being responsible for the engagement and payment of that labour.

Note however that this approach would define "employment or self-employment" for tax purposes only and not for employment law purposes.

Some of the key questions in the consultation paper on which the Government is seeking views are:

- whether or not the criteria represent a fair indicator of a person who is running his own business and is genuinely self-employed?
- whether there are any other indicators which ought to be included, for example, VAT registration often signals that the worker is in business on their own account so should the additional requirement of VAT registration be included in the criteria?
- as for who would apply the test, the person responsible for making the payment to the worker will apply the criteria and depending on the circumstances the payer could be the actual engager themselves, an employment agency or an intermediary. The government is asking whether the payer is in fact the correct person to have responsibility for applying the criteria and operating PAYE and NICs.

The consultation exercise ends on 12 October 2009. It is not known when the changes will be introduced but it has been confirmed that HM Revenues & Customs will conduct a review within three years of the changes being introduced to establish the costs and benefits and whether they have been effective in dealing with the problem of false self-employment.

More information

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