

## Contractors need a definition of self-employment

For John Kell, policy director of the London-based [Professional Contractors Group](#), the definition of self-employment will resolve many contractor taxation issues. This is part of [our thought leadership series](#) on the way forward for contractors and tax.

The key question is: how should contractors be taxed? Clearly, the current system doesn't work, and attempts to repair it have been patchwork -- "bits of sticking plaster" to use the phrase coined by the House of Lords Economic Affairs Committee. (See [Contractors Find Support for Lords' Critique of Contractor Tax](#))

John Kell suggests that we can move forward into a new approach if we define once-and-for-all in law what the difference between the self-employed and the employed is. Here is his explanation in response to our questions.

ContractorCalculator:

Contractors exchange the security of a job for the chances of the project market. They enjoy the advantages of not having to pay much in national insurance contributions and direct income tax. They have the advantages of deducting [expenses](#). Should contractors continue to enjoy these advantages, or should they give up some of them in exchange for a regime where they have more security?

Kell:

Contractors are currently taxed on a business basis because they expose themselves to commercial risk and are therefore in business on their own account. They should – indeed, must – therefore be taxed like any other business, either like any other [limited company](#) or like any other unincorporated sole trader (or appropriately for whatever other business form they take, eg LLP).

There are clear and sound reasons for this: being self-employed, contractors have to fund their own holiday pay, sick pay, training costs and periods out of contract. The business tax treatments recognise these risks: they allow the contractor to earn a reward if they make a good job of taking these risks. Expecting contractors to maintain a self-employed existence while being remunerated on a full PAYE basis would be unreasonable – some choose to do so for various reasons, but it would be unreasonable and wrong to force this treatment on all self-employed people.

These tax treatments are relatively clear – not necessarily simple, but certainly well-established and widely understood. PCG does not advocate that they should be changed.

Difficulty only arises when a contractor's status is questioned – usually by the Revenue. If they are not genuinely in business, it is fair to say that they should not be entitled to be taxed as a business. Unfortunately, the Revenue often doesn't recognise a genuine business when it sees one and challenges many contractors – and other self-employed people – incorrectly. [IR35](#) institutionalised this problem.

The solution must therefore be for status, rather than the tax treatments arising from it, to be clearer. If status is clearer, the Revenue cannot challenge contractors incorrectly with such abandon.

This is why PCG advocates that employment status should be clarified and placed on a statutory footing, and IR35 accordingly abolished. This will give contractors and clients a clear interest in establishing proper commercial relationships (as, unlike under IR35, failure to do so would make the client liable for employment rights), and would make status disputes much easier to resolve. Indeed, it would make it far harder for the Revenue to attack contractors using complex and murky areas of status law, as such areas would no longer exist.

A tax regime that foisted some sort of 'security' on contractors would risk destroying the UK's freelancing model. Implicitly, such security must be security against commercial uncertainties. This would remove the sound reasons for contractors to be taxed like any other business, and would make them far less attractive to clients as, presumably, clients would be under some sort of ongoing obligation to their contractors. Contractors currently offer a cost-effective way for clients to obtain – and dispense with – particular skills and capabilities in accordance with specific demands: if this facility were removed, clients would do just as well to hire employees, and contracting as we know it would be dead.

ContractorCalculator:

How can we avoid the traditional dichotomy between the employed and the self-employed?

Kell:

“ The Revenue often does not recognise a genuine business when it sees one and IR35 institutionalised this problem ”

John Kell - PCG

This dichotomy cannot and must not be avoided: it must be embraced, clarified and enshrined in law. Only when the dividing line between employed and self-employed is crystal clear will have an end to the current status problems that afflict contractors. Rubbing out that divide would destroy contracting.

ContractorCalculator:

Is it possible to have separate solutions for high-earning contractors and those on the low end?

Kell:

All contractors expose themselves equally to commercial risk, so it is hard to see why they should be taxed differently depending on some other factor. How much a contractor can command in fees – that is, how much a client is willing to pay for a particular set of services and skills – is determined by the market. If a contractor is finding that they cannot command a sufficiently high rate to make contracting commercially viable for them, they can either seek permanent employment or find some way of enhancing their value proposition for clients.

Low-earning contractors should no more expect to be bailed out by the tax system than high-earning contractors should be made to pay more tax (present income tax bands and the like notwithstanding): all are in a competitive marketplace and taking the risks that entails. All should be equally exposed to the risks and equally entitled to the rewards.

ContractorCalculator:

What legislative change is possible?

Kell:

We would advocate that the legislative change should contain a definition of "employment" that uses the existing tests developed in case law: personal service, mutuality of obligation and direction and control.

It would undeniably be a difficult exercise, as a range of lesser pointers also exists in common law, and consideration would need to be given to how to treat them. But, fundamentally, anyone not within all three key employment tests would not be an employee. Beyond that, the existing definitions of "worker" as attached to various existing measures such as holiday entitlement would still pertain; anyone outside these tests and the employment test would be self-employed.

“ Legislative change should contain a definition of employment that uses the existing tests developed in case law ”

John Kell - PCG

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