

Independent contractors – what are they? Employed or self employed?

Independent contractors are self-employed workers who provide services for an organisation under a [contract for services](#). Independent contractors are not employees and are typically highly skilled, providing their clients with specialist skills or additional capacity on an as needed basis.

Being self employed and trading via a [limited company](#), partnership, as a sole trader or through an [umbrella company](#), independent contractors can often pay less tax than employees, which results in higher net pay, so they take home a greater proportion of their gross earnings.

Independent contractors in the UK must be aware of the [IR35 tax legislation](#). This was introduced in 2000 to catch '[disguised employees](#)' and apply income tax and National Insurance Contributions (NICs) to independent contractors' income as if they are employees.

What is an independent contractor?

According to [HMRC's definition of employment status](#), an independent contractor works for a client organisation under a contract *for* services, whereas an employee works under a contract *of* service. In addition to the contract, it is the actual working arrangements that will [determine IR35 status](#) whether the worker is an independent contractor or an employee.

HMRC provides an [Employment Status Indicator \(ESI\)](#) tool that workers can use to determine whether they are employees or self employed. Although HMRC's tool can be helpful for workers concerned about employment status, ContractorCalculator's free [IR35 Employment Status Test Tool](#) has been developed specifically to help independent contractors gain an accurate assessment of their IR35 status.

Other tests of employment have been developed over many years by the courts, and the key factors that determine whether a worker is an independent contractor depend on the tests of [control](#), [substitution](#) and [mutuality of obligation](#).

When applied to determine whether independent contractors are disguised employees and inside IR35, these tests have become notoriously unpredictable, leaving many unsure of their exact tax status.

Key tests to determine if a contractor employed or self-employed

If the client specifically tells a contractor how to perform a task, what task to perform, when to perform it and where the task should be performed – known as 'how, what, when and where' tests – then the workers is probably controlled by the client and therefore an employee.

Should a contractor be required to perform the services themselves, without being allowed to provide a substitute, then this, too, is an indication of employment. Having a substitution clause in a contract and actually supplying a replacement helps prove that the worker is actually an independent contractor.

Mutuality of obligation, also known as 'MOO', is where an employer is obliged to provide work and the employee is obliged to perform the work. If a worker has to perform any task allocated by the client, and is not focused on a specific project, then there is a mutuality of obligation and the worker is probably not seen by HMRC as an independent contractor.

Other factors that identify an independent contractor

Although control, substitution and mutuality of obligation are considered by experts to be the key factors that determine whether a worker is an independent contractor or an employee, there are other factors to consider.

These include asking: whether the worker is '[in business on their own account](#)'; if they are [part and parcel](#) of the client's business; whether they are taking [financial risk](#); if they are providing own equipment; whether they are in receipt of employment benefits; if they have the opportunity to profit; and whether they have a right to terminate the contract.

HMRC will use these tests of employment when assessing an independent contractor's IR35 status. If the worker is found to be a disguised employee and therefore inside IR35, they are likely to be asked to pay significant back taxes, NICs, interest and penalties.

Contracting abroad – how other countries define independent contractors

Other major contractor markets such as Canada, Australia and the United States of America have their own tests for disguised employees. These differ from IR35 and in some cases provide independent contractors with greater certainty over their tax affairs.

In the USA, the [definition of an independent contractor](#) is well established. But it is employers who foot the bill for unpaid taxes and social security bills if an independent contractor is found to be a disguised employee.

Australia uses a [three-step test](#) to determine whether an independent contractor's income is actually Personal Services Income, and therefore taxed as

employment income. Canada uses a [similar framework](#) to the UK, but the employer and not the contractor foots the bill for unpaid taxes and social security contributions.

The UK tests of employment to determine whether a worker is a disguised employee, inside IR35 and therefore not an independent contractor are still in force. However, they are being reviewed (see [IR35 Tax review](#)) as part of a wider review of small business taxation.

This is a complex area and potentially expensive for those who fall foul of IR35, so independent contractors are advised to use [ContractorCalculator's IR35 test](#) and seek professional assistance.

Published: Sunday, December 19, 2010

© 2016 All rights reserved. Reproduction in whole or in part without permission is prohibited. Please see our [copyright notice](#).



ABCe verified website - last audit confirmed *134,482 monthly unique visitors*

© Copyright 2016 Byte-Vision Limited UK. All rights reserved [Copyright notice](#)