EMPLOYED OR SELF-EMPLOYED?

Alec McIlhinney

After working for 11 years in the Inland Revenue, Alec McIlhinney is now Group Taxation Manager for Rowntree Mackintosh, plc, York. He has had wide experience of local church life.

Whether or not an individual is an employee, as distinct from a self-employed person, is crucial to the determination of rights and obligations in taxation, National Insurance Contributions (NIC), redundancy pay, health and safety and sick pay (and maternity rights). Third parties, such as insurance companies, may need to ascertain status in relation to liability to injury.

Care should therefore be taken that the agreement between church and FTW is comprehensive and unambiguous; failure to make the correct deductions or pay the appropriate contributions can lead to recovery proceedings for several back years.

The Inland Revenue (IR) has recently published a booklet (IR56) entitled *Employed or Self-Employed?*. This is a helpful but by no means comprehensive guide to the factors that must be taken into account in deciding whether a person is an employee or self-employed.

Other useful general publications:

Employers' Guide to PAYE (P7),
Employers' Guide to NI Contributions (NP15).

If in doubt, the local tax office or DHSS office should be consulted.

Two preliminary warnings: first, many tax allowances and rates change annually, as do state benefits and NIC, and maintaining up-to-date information is important; second, the notes which follow do not pretend to be anything like comprehensive and the importance of enlisting professional help must be emphasised.

The Employee Worker

The employer has a statutory obligation to deduct income tax under PAYE rules, and to account for it to the collector of taxes; and to ensure

that Class I NICs are also paid by both employer and employee to the collector.

It may be thought appropriate to provide for the FTW's retirement by ensuring that contributions towards a private pension are also made by both parties. There are rules governing the approval of schemes and the amounts of allowable contributions (see IR pamphlet 12). Employee contributions are deductible for tax.

Some employers provide life assurance cover, as well as the more usual benefits relating to transport and residence. Employers' liability for accidents, etc, must also be covered.

In any event, it must be clear who pays what: car purchase and running costs, gas, electricity, telephone, rates, rent/mortgage, etc.

Tax under Schedule E is charged on the 'emoluments' of an office or employment, including 'all salaries, fees, wages, perquisites and profits whatsoever'. Lest any doubt should remain, where inclusive earnings are £8,500 or above further legislation ensures virtually every benefit in kind, whether convertible to cash or not, is also assessable.

It seems reasonable that the FTW should earn at least the average of all male workers, or perhaps, as some churches have decided, the average of the incomes of all members in employment. If so, it will often follow that his earnings (which for this purpose include the value of all benefits) will exceed the limit of £8,500 (unchanged since 1979) above which the FTW becomes a 'higher paid employee' (sic).

Benefits in kind (often referred to as 'fringe benefits') include, eg, the provision of a car and petrol (both taxed on a fixed scale, changed annually), a loan at a reduced or nil rate of interest, accommodation, payment of mortgage interest. A return of benefits must be made annually to the IR by the employer in form P11D, and by the employee in his tax return. IR booklet 480 gives guidance.

The employee is entitled to deduct from these amounts any expenses 'wholly, necessarily and exclusively' incurred in the performance of his duties—words which are notoriously rigid and restricted in their operation (and in contrast to the more liberal allowance of expenses to the self-employed).

In practice, the 'business' proportion of expenditure will be allowable; some relief should be given for a room in the home set aside for study/counselling; but the cost of home-to-work travel is not allowable, nor would be the purchase of most books and journals (or the CBRF subscription). The Revenue will need to be persuaded of the reasonableness of amounts claimed—and attitudes may vary in different tax offices.

Other points which might arise include:

1. The FTW's freedom (need?) to earn elsewhere: the status of this money can be difficult to determine.

2. Gifts other than salary: these are taxable if they arise out of the employment but not if given in a personal capacity—a fine distinction.
3. Working partly abroad and partly in the UK—again tax complications can ensue.

The Self-Employed Worker

The self-employed person in a profession or vocation is not subject to 'Pay as you earn'. Instead he pays tax under Schedule D direct to the collector of taxes in January and July annually some considerable time in arrears: for example, tax due on the earnings of the year to 30/6/86 will, in the normal case, be payable in two equal instalments on 1.1.88 and 1.7.88.

He is charged, not on 'emoluments' but on his 'profits or gains' (comprising incomings less outgoings). The 'necessarily' test does not apply and he may claim expenses 'wholly and exclusively laid out or expended for the purposes of the profession or vocation'. Clearly this gives him far greater scope than the employee enjoys.

Again where there is a private element (as with car expenses, telephone, study room etc) an apportionment will be agreed. Allowances for depreciation on some capital assets (eg motor car) may be claimed.

The *total* earnings of the FTW's spouse are tax-free up to £2205 (about £42 a week), although some NIC may be payable. Wages paid by the FTW to his wife can be claimed as an expense provided these can be justified by the duties carried out. Reasonable remuneration should not be difficult to substantiate. Where, for example, do you find someone willing to be on duty at all hours for £40?

Class 2 and Class 4 NICs are due from the self-employed. In 1985-86 these would amount at most to £821, and one half of the Class 4 contributions (£303 maximum) can be deducted for tax. (By contrast, the employer's and employee's Class I contributions can together amount to £1,240 in 1985–86.)

A self-employed person is entitled to relief for contributions made towards an annuity for retirement. The maximum level of contribution allowable is 17½% of annual earnings (less capital allowances)—a little more than that when nearing retirement.

There are, however, other consequences which flow from self-employed status, and these should be weighed carefully alongside the likely financial benefits.

1. The self-employed do not come within the ambit of the EP(C)A 1978, and thus have no statutory rights as regards, for example, sick pay. Fewer state benefits are available.

2. Pension provision is the responsibility of the individual. This is a matter which should command diligent and early thought by both parties.

3. For the self-employed FTW (if not for the church or churches among whom he moves) there is a significantly greater burden of record-keeping. A simple cash-book recording all receipts and payments should normally suffice provided it is kept scrupulously up to date (ie, *not* written up every other week!).

At yearly intervals the inspector of taxes will ask for a statement of income and expenditure. Receipts or written evidence for expenses should be retained in case they are asked for and details of 'business' and 'private' car mileage jotted down. As with the employed FTW, uncertainty *can* arise over the status of sums received. It is particularly important that the source of 'private' money banked should be recorded in case a query arises later.

Some Conclusions

Comparison of the treatment of the employee with that of the self-employed can provoke differing conclusions. Some may feel that the administrative burdens and strict rules inherent in the PAYE system are onerous, and favour the self-employed route. On the other hand, there is some measure of certainty and immediacy which may be welcome. In other respects, however, the balance of advantage may lie the other way (eg employment protection and pension arrangements). Again, therefore, the message is clear: the contract must be meticulously thought out in advance, with input from both parties, and preferably also from a Christian professionally engaged in a relevant discipline.

Overall, though, it may be suggested, on balance, that, provided proper care is taken over non-fiscal matters, the self-employed route is preferable, and an agreement should be drawn up accordingly. This is not just a question of trying to secure the most favourable financial position: in most cases, it will accord more nearly with reality. It is unlikely that in church/FTW relationships there will exist the measure of detailed control over the way he carries out his tasks to establish a master-servant position. If, however, it is clear that there is truly an employee position, then all the consequences must be accepted and the authorities informed accordingly.

The expression of intent in the agreement will be an important, though not necessarily conclusive, pointer towards the character of the relationship. As a general rule, greater significance is attached to an expression of intention where there is confidence in the bona fides of the parties.

Finally, and obviously, there must be a cheerful prior commitment to regular giving in the church—and the treasurer should persistently press the advantages of deeds of covenant.