Consultants – are they really self-employed?

Mike Ingmire, senior tax manager at Hazlewoods, looks at a firm's responsibility for distinguishing between consultants and employees. He explains the importance of not only getting the terms of contract right, but also of sticking to those terms in practice.

There are inherent complications in the new tax legislation for fixed share LLP members, which may tempt law firms to engage an individual as a consultant, rather than an LLP member, and thus side-step the rules. LLP members nearing retirement may look to withdraw from the LLP, not take on more risk and increase their investment.

It is the firm's responsibility to assess whether a consultant is genuinely self-employed or is in fact an employee. Incorrectly treating the individual as self-employed can be very expensive: HM Revenue & Customs will seek to collect the PAYE tax and National Insurance from the firm, possibly going back a number of years. A tax indemnity in the contract may offer protection, but it is better to get it right from the outset.

There is no single test to determine an individual's status and in recent cases the courts have taken into account a range of factors when giving their ruling.

Control

Consider the 'what, when, where and how' of the services to be provided. Employees are subject to supervision and control by the employer, whereas consultants can decide what work to accept, what hours are needed to deliver the services, where to do it (at home, at the firm's offices, somewhere else) and how best to perform the services.

Substitution and assistants

Employees are engaged for their personal service and assistants are provided by the firm, whereas consultants may be able to provide a suitably qualified and experienced substitute in their place and may engage assistants at their own expense.

Financial risk

Consultants generally provide their own equipment (computer, mobile phone) and incur their own overheads (PI insurance, practising certificate, training), whereas the firm provides these for employees. A consultant might be required to reimburse the firm for these costs or make a contribution towards them: the firm pays the cost centrally.

Exclusivity

Employees are expected to work exclusively for the firm: consultants may be engaged by more than one firm.

Payment

Consultants may be paid an hourly or daily rate in arrears and on presentation of an invoice, provided they are only paid for hours or days actually worked. Employees may be paid weekly or monthly and may benefit from overtime, bonuses, holiday pay, sick pay and pension provision.

Integration into the practice

Employees are integrated into the business, with their own desk, office, a job title within the firm's hierarchy and a firm's email address. They may also be responsible for managing or supervising other employees. Consultants remain independent.

But consider too whether the consultants act like employees. Do they use the same system logins and passwords, attend the same functions and adhere to the same internal procedures? If you find a consultant reading the employee handbook, you may have a problem.

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The consultancy contract is just the starting point: getting the terms right is important and they must be replicated in practice. If the actual relationship between the consultant and the firm differs from the contract, the wording will be ignored by the courts.

Finally, if a consultant operates through a limited company, the above factors still apply, but the risk of getting it wrong then lies with the company, rather than the firm.

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