

## DIRECT CONTRACTORS - THE FACTS

It has recently been suggested that the engagement of a contractor directly by a client (without an agency) carries the risk of the contractor being held to be an employee of the client, and entitled to employment rights. This is misleading.

### **Does IR35 make a contractor an employee?**

**No.** The IR35 legislation asks whether a contractor engaged through his own limited company *would have been* an employee if engaged as an individual. In such a case the contractor's company must account for tax on his fee as if it were personal salary.

It is important to note that the client is not liable for any part of the tax. PAYE, employees NICs and employers NICs must all be paid by the contractor's company.

Nor is the employment status of the contractor affected. The Inland Revenue's guidance on IR35 states: "*Under this legislation, the client will not become your employer. ... All employer responsibilities fall on the service company as they have always done.*" <<http://www.inlandrevenue.gov.uk/ir35/faqsgeneral.htm#38>>

### **Can a contractor ever be held to be an employee?**

**In theory, yes.** Workers engaged through limited companies have on occasion been held to be employees of their clients. While this has happened for example in the case of a crew hand on a river bus, there are no known cases of an IT or Engineering contractor working through a limited company (whether through an agency or directly with a client), being deemed to be an employee of the client.

### **Does an agency prevent an employment rights claim being successful?**

**No.** In several cases where employment rights claims have been upheld, the courts have looked through the agency and found employment with the client (e.g. *Davidson and Melville Craig Group Ltd v Motorola Ltd*; *Jarvis and Others versus Brentvine Limited and Esso Petroleum Company Limited*). In no case has the use of an agency been held to affect the decision. If an employment relationship is found, it will be with the business for whom the contractor works on a day-to-day basis, i.e. the client.

In the light of this, the advice of certain agencies that clients should refuse to deal with contractors directly, or move them to engagement through those agencies, is unnecessary, and will achieve nothing but the additional cost of that agency's mark-up. The claims of one such agency are currently the subject of a complaint to the Advertising Standards Authority by PCG.

### **How can I be sure a contractor is not an employee?**

The only way to ensure that a contractor will not be classified as an employee is to make sure the terms of the engagement are not those of an employment relationship.

Since the employment tests are used as part of IR35, it follows that contracts that fall outside IR35 will with even greater certainty fall outside the provisions of employment law. Conversely, while IR35 does not confer any employment rights, it seems likely that contractors who are taxed as employees will be more likely to wish to claim employment rights in the future.

In neither case will it make a difference whether the contractor is engaged 'direct', or through an agency. However it must be noted that 'standard agency contracts' are regarded as an employment pointer by the Inland Revenue. There will often be more flexibility when negotiating directly with a contractor.

Guidance on the drafting of contracts under IR35 is available on the PCG website.