

Annex D - Understanding employed and self-employed earners

This annex explains the various types of employment and self-employment status an NRP may have and provides guidance for dealing with cases where the NRP's employment status is complex, for example where the NRP is a company director.

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Establishing if an NRP is employed or self-employed

An NRP can hold one or more types of employment at the same time. This means that income could be received in a number of different ways and the evidence gathered should reflect this.

An individual who starts their own business can choose between trading as

1. an unincorporated business either as

1.1 a sole trader, or

1.2 in partnership with others,

2. a company where the individual is a

2.1 director and, or

2.2 shareholder, or

3. a partner in a Limited Liability Partnership (LLP).

An NRP who is a director may consider themselves to be self-employed. Where there is an indication that the NRP is a director, this must be confirmed. Confirmation can be obtained from Companies House. Refer to [Chapter 38: Information gathering](#).

If the NRP is paid a salary by their own company, they are employed by that company.

If the NRP earnings consist of the profits of the company but not drawings, they are self-employed.

In most cases, a director of a limited company will be an employee, and the requirement to complete a

SAR does not automatically mean an NRP is self-employed.

There are exceptions such as Office Holders. See below for more information on Office Holders.

Companies can grant franchise rights to permit a franchisee to trade using their Trademark or Trading Name. If an NRP is a franchisee it will be necessary to establish whether they are taxed on their profits, or whether they take a wage from the business and are taxed on a PAYE basis. This will determine if an NRP is self-employed or employed.

Types of Employment

This section contains details on various types of employment status an NRP may hold. Where an NRP is considered to be employed, current income should be gathered. Refer to [Chapter 19: Current income employed](#).

Employed

A person is employed usually but not exclusively by one company and the NRP pays tax via the PAYE system. There will usually be a contract of employment between the NRP and the company that they are employed by. An NRP may have multiple employers.

Office Holder

Office holders are not employees or workers. There is no contract or service agreement relating to an office holder. An office holder's duties are minimal and are only those required under the relevant statute, constitution or trust deed. Effectively, an office holder works as an independent office and are not under the close supervision or control of the appointing body.

An office holder will not receive a salary or any form of regular payment for their services. They will receive a voluntary payment, known as an honorarium, regardless of the work they do. Tax and NI are deducted by the appointing body.

Directors

Directors are usually employees of the limited company they are a director of, unless they are an office holder. A director may or may not own the company. They are liable to pay income tax and Class 1 NI contributions in the same way as other employed people.

They are required to be registered through the company for PAYE. A director will generally take wages in the form of PAYE income.

In addition, a director may receive dividends based on their share of the shareholder funds, if they hold shares in the company. They must also register for self-assessment and complete a SAR annually for

their whole earnings.

There are various kinds of directorships, some of which do not require registration for PAYE. Each case must be considered on its own merits.

A director's income may include the following

1. remuneration,
2. share dividends,
3. debenture interest, or
4. drawings from the company.

Directors of limited companies may take some of their income in the form of dividends. A dividend is a payment that is allocated to shareholders in limited companies from the company's profits. For the dividends to be considered in the calculation, an application for a variation is necessary. Refer to [Chapter 33: Unearned income](#).

Note: not all directors are able to or will receive dividends.

Director Loans

Some directors can and do take significant amounts of money in the form of loans from company accounts. The loan must be subject to agreement at the time of approval by the company.

Monies received from genuine loan accounts are not earnings for CM purposes. They are a loan of capital from the company to the director.

Drawings

Directors may draw money from the company during the year. Such drawings are usually repaid at the end of the year. In most cases the amounts drawn do not actually belong to the director. Drawings are therefore not usually considered as earnings and are different to dividends.

Where drawings have been reported by a case party, the DM will need to establish the basis on which the payment is drawn to confirm whether it may constitute income for CM purposes.

Directors have no legal right to receive payment for their services as a director, but can still be voted payment. If a director has been voted payment, often referred to as voted remuneration, at the Annual General Meeting, a drawing which is part of that should be regarded as earnings.

Alternatively, it may be that the company cannot afford to pay voted remuneration because of a decline in business and, or the director is drawing money from capital that the NRP has loaned to the company.

In this situation, the payment is ignored for CM purposes.

Shadow Directors

A shadow director is a person who is not on the formal list of directors but who controls the company's activities to a significant extent. These may be individuals or companies and a shadow director has the same duties and obligations as any other director.

A shadow director is not an office holder. Any payments received by a shadow director will likely be paid under a contract of some kind. A shadow director is likely to be considered as employed for CM purposes.

If this cannot be ascertained, the DM should contact A&G or consider a referral to FIU.

Acting as a shadow director is not an offence in itself, unless the person is an un-discharged bankrupt or disqualified from being a director.

PAYE Limited Liability Partnership Members

In some circumstances, an individual of a limited liability partnership may be salaried, in which case they will have an employment contract. If the partner does not have an employment contract, they can still be treated as employees for tax and NI purposes if all of the following conditions are met

1. the individual has no significant influence over the affairs of the partnership
2. the individual performs services for the LLP in exchange for an income of which at least 80% is fixed. The income may be variable but not affected by the LLP's overall profits or losses. This is known as a disguised salary.
3. the individual's contributions to the partnership is less than 25% of the disguised salary.

It is possible for an LLP to have both self-employed and employed individuals.

In most circumstances only senior partners have significant influence over business affairs. Where this applies, LLPs are required to pay salaries and NI contributions through PAYE.

Unlimited Liability Company

Directors of unlimited companies which are registered and incorporated are treated the same as directors of limited companies for CM purposes.

Limited Companies

A limited liability company is so called because its liabilities for debts are limited to the assets of the

company. It is an organisation that an individual, or a number of individuals can set up to run their business. It is responsible in its own right for everything it does, and its finances are separate to those of the individual members. Those who set up and run the company have no personal liability beyond their individual stake in the company. This stake is usually in the form of shares, which often have a nominal value only.

Any profit it makes is owned by the company. The company can then share its profits with its shareholders.

Every limited company has 'members' - the people or organisations who own shares in the company. Directors are responsible for running the company. Directors often own shares, but they do not have to.

The payment of share dividends, depends on the number of shares held and is generally called unearned income. Refer to [Chapter 33: Unearned income](#)

A limited company must trade under its registered name, which should appear on any correspondence from the NRP employer.

It should be clear from such correspondence that a limited company is involved, but that does not, in itself, mean the NRP is a director. A limited company can be of any size and the directors may include only the NRP, or the NRP and one other person, with no other employees.

Each limited company is required to have the following:

1. a Memorandum of Association - this sets out the company's relationship with the outside world, e.g. business objectives, company name, amount of authorised share capital
2. Articles of Association - this sets out the relationship between the company and the shareholders, and between each shareholder, the powers of directors and the internal organisation of the company.

Types of Self-Employment

This section contains detail on the various types of self-employment an NRP may have. Where an NRP is considered to be self-employed, current income should be gathered. Refer to [Chapter 20: Current income – self-employed](#).

Self Employed

A self-employed person works for themselves and is not contracted to one company. A self-assessment tax return (SAR) is completed annually.

Contractors and subcontractors

A company can enter into a contract for services where agreed services are provided to a client for a set fee and usually for a set duration. These are contractors. This is not the same as an employment contract.

Subcontractors undertake a contract from the contractor. The contractor is responsible. A Subcontractor has a contract with the contractor for the services provided. This may be any type of work for a self-employed individual.

Contractors and sub-contractors are often referred to as sole traders.

If the NRP is self-employed and is a contractor or a subcontractor, they will need to register with HMRC.

The Construction Industry Scheme (CIS) sets out the rules for how payments to subcontractors for construction work must be handled by contractors in the construction industry.

Business Partnerships

In business terms, a partnership is defined as "...the relationship which subsists between persons carrying on a business in common with a view of profit".

People can enter into a partnership under an agreement, which may be written, for example a deed of partnership, verbal or implied. A deed of partnership includes details of how any profit, or loss, is shared between the partners. In the absence of an agreement any profit is usually shared equally among the partners.

Self Employed Partnerships

In a self-employed partnership, each partner is self-employed. Clubs, charitable organisations, and registered companies – except for Limited Liability Partnerships – should not be treated as self-employed partnerships.

Limited Liability Partnerships

A limited liability partnership is a partnership in which some or all of the partners have limited liabilities. It provides the benefits of limited liability but allows its members the flexibility of organising their internal structure as a traditional partnership.

An LLP is a separate legal entity to the individual members. This means that, while the LLP itself will be liable for the full extent of its assets, the liability of the members will be limited.

All partners need to provide HMRC with their own tax returns as individuals. This must be registered by 5 October in the business' second tax year.

It is possible for an LLP to have both self-employed and employed individuals.

Companies House

Where a PWC reports that the NRP is a director or sole director of a company and further information is required, Companies House can provide confirmation of the NRP's status. Refer to [Chapter 38: Information gathering](#).

Evidence required

Income Type	Evidence Requirement	Further information
Employed	Salary, wages (PAYE)	Refer to Chapter 19 - Current Income - Employed Refer to Chapter 97 - Evidence - income
Sole Trader	Individual Self-assessment tax return	Refer to Chapter 20 - Current Income - Self employed Refer to Chapter 97 - Evidence - income
Self employed partnerships	Individual Self-assessment tax return	Refer to Chapter 20 - Current Income - Self employed Refer to Chapter 97 - Evidence - income

Business partnerships	Individual Self-assessment tax return	Refer to Chapter 20 - Current Income - Self employed Refer to Chapter 97 - Evidence - income
Limited Liability Partnerships (LLP)	Individual Self-assessment tax return	Refer to Chapter 20 - Current Income - Self employed Refer to Chapter 97 - Evidence - income
PAYE - Limited Liability Partnership Members	Salary, wages (PAYE)	Refer to Chapter 19 - Current Income - Employed See above
Directors Limited and Unlimited	Salary, wages (PAYE)	Refer to Chapter 19 - Current Income - Employed Refer to Chapter 97 - Evidence - income See above
Director Loans	Not Earnings	See above
Director Drawings	See above	
Dividends	Unearned Income Variation - Individual Self-assessment tax return	Refer to Chapter 33 - Unearned Income Refer to Chapter 97 - Evidence - income See above