

**The difference between Directors and the Self-Employed: explaining the stark contrast between coronavirus relief funds for both kinds of workers.**

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Since Rishi Sunak announced the government's support packages for workers over two weeks ago, much has been written, speculated over, and squabbled about regarding the stark contrast in support for Limited Company Directors and the Self-Employed during the coronavirus crisis.

We were among those quick to call out the imparity of these measures via social media where a tide of misguided criticism was gaining momentum: "*Directors get massive tax breaks and don't deserve any support*" led to, "*Why should Directors get support when they pay far less tax than the employed or self-employed*" and even, "*Directors should have planned better and shouldn't be asking for handouts.*"

Reading between the lines though, the social media backlash aimed at Directors for seeking financial support is often a misunderstanding about what a Director is, and how this status affects them.

Many people just don't understand the fundamental difference between a Director and a Self-Employed person - and quite honestly, why should they? From the outside they both look the same, the only difference is the badge of a Limited Company even though they're both 'working for themselves'. Frankly, no one was interested until five minutes ago. But since coronavirus hit, this issue has triggered industry insiders and armchair critics alike.

The irony is that in many instances it makes little difference about which category you *officially* fall into. Your employment status is really a question of perception.

**How the outside world sees Limited Company Directors**

Upon hearing that you run your own business, most people assume that you're Self-Employed and HMRC would class you thus. They're not wrong (in theory), but in practice you pay yourself differently and therefore the taxman, too. The bottom line is, 'working for yourself' is often misconstrued as 'you're self-employed.'

**How HMRC see Limited Company Directors**

In most instances Directors are actually employees of their own Limited Company. They are (for the most part) the same as on-payroll employees (i.e. paid a salary via a PAYE system, albeit alongside dividends), and therefore *not* Self-Employed.

That employment status is decided as such: a Limited Company is one thing and a Director is another operating the company – two separate legal entities. A sole trader who's Self-Employed *is* the business, so they aren't a separate entity from it.

**How lenders see Limited Company Directors**

During a mortgage application process many lenders will treat a Director as Self-Employed: 'that'll be three years of SA302 and Tax Year Overviews, please'. The same philosophy applies in the wider world of finance when lending from both regulated and non-regulated institutions. But why the short shrift for Directors seeking credit? Well, that's simple. You don't have guaranteed work, so you're a risk. (Whisper it, but, in these circumstances *you're as good as Self-Employed to us*).

**No wonder everyone's confused**

We've had it reported to us this week that the Government's own Universal Credits department are actively *telling* Directors that, "for the purpose of Universal Credit, we class you as self-employed".

In case you were wondering, the reason why there are so many small companies with only one Director these days is because for a number of years larger businesses have said they'll only work with, and accept tenders and quotes from, Limited Companies, creating something of an adapt or die culture.

## So what's the deal with Directors and the government support schemes?

On one hand there's the **Self-Employment Income Support Scheme** for sole traders to claim up to 80% of their income, and on the other, the **Job Retention Scheme** (JRS) meeting up to 80% of the salaries for furloughed employees. The bailout measures are unprecedented, sure. But are they fair? Not quite.

Whilst Directors can furlough themselves and claim from the JRS pot, there's a catch. The JRS only covers up to 80% of an employee's salary, not dividends, which means where Directors are concerned the support available is only a fraction of their actual income and far less than what their Self-Employed counterparts will be remunerated with, even though both parties work for themselves.

The disparities in support paired with the misinformed arguments circulating online has created a perfect storm where even Directors themselves are struggling to justify their argument for fair government backing.

To help unpack some of this, the following chart shows a working example of a Limited Company and its Director with profits of £25,000 alongside a sole trader (a Self-Employed person) running (for illustrative purposes) a company with an identical profit. *\* the mathematics of the illustration have included tax and NIC as a full and fair comparison for the purposes of the report*

	<b>Director</b>		<b>Self-Employed</b>
Company Profit	£25,000.00	Business Profit	£25,000.00
Take off Salary ( <i>Paid by Company as Tax expense</i> )	-£12,500.00	Take off Tax Allowance	-£12,500.00
Take of NIC ( <i>Paid by Company as Tax expense</i> )	-£533.78		
Profit Charged to Taxation	£11,966.22	Profit Charged to Taxation	£12,500.00
Corporation Tax Payable	£2,273.58		
Balance for Dividends	£9,692.64		
Corporation Tax Payable	£2,273.58	Tax	£2,500.00
NIC Paid on Salary	£464.16	Class 2 NIC	£156.00
NIC Paid by Company on Salary	£533.78	Class 4 NIC	£1,473.12
Tax on Dividends	£576.95		
<b>Total Tax and NIC</b>	<b>£3,848.47</b>	<b>Total Tax and NIC</b>	<b>£4,129.12</b>
<i>Actual total tax and NIC %</i>	<i>15.39%</i>	<i>Actual total tax and NIC %</i>	<i>16.52%</i>
<b>Difference in Tax paid</b>	<b>1.13%</b>		

We can see that two identical profits from a Limited Company and a sole trader pay very similar rates of tax on the same income (when you factor in National Insurance).

Excluding National Insurance, the tax is 26.5% for Directors and 20% for sole traders which is an unfair comparison.

When we compare the Director's furloughed pay claim to what the sole trader with the same profit is eligible for, the inequities really come to light:

- (i) A Director can claim 80% of their salary at £833.33 per month
- (ii) The sole trader can claim 80% of their income at £1,667.67 per month

Judging by these figures:

- Is it fair that two similar companies run by people 'working for themselves' should be treated so differently in respect of support?
- Is it fair that two similar companies run by people 'working for themselves' should be told two different things? (The rules state that to make a claim Directors can only fulfil statutory duties and obligations, whereas sole traders can still work).
- Is it fair that two similar companies run by people 'working for themselves', paying broadly similar tax and contributing to the economy should be treated differently *at all*? Do both not have the same bills, liabilities and families to support?

How can the calculation for a Director's furloughed pay be based on salary alone whilst the Self-Employed allowance is calculated on profits before tax?

### **An ideal resolution**

I understand the government made a conscious decision in respect of how the support is given. I understand that it's (regrettably) unlikely to change, although I hope that it does. I understand that the system of support was rushed out, and rightly so, and I respect that there are many other things for the government to be focusing on right now.

What I don't understand is why a Director can't be treated as Self-Employed in this scenario as they are in others; why can't a Director make a claim based on their combined income of salary and dividends, i.e. their **income before tax** in the **same way** as the Self-Employed?

### **If things were to change, the outcome would be as follows:**

- (i) A director can claim 80% of their income (including dividends) at £1,479.51 per month
- (ii) The sole trader can claim 80% of their income at £1,667.67 per month

The difference between the two claims would sit at £187.16 per month because a Director 'earns' slightly less and pays slightly less tax than someone who's Self-Employed. This seems fair.

Add to that a change in policy over Directors working during this time to operate their companies and the problem is solved.