



GUIDE TO CONTRACTS OF EMPLOYMENT

This guide is designed to help those PCG members who either wish to enter into formal contracts of employment with their own one-person companies, or have now decided that they fall foul of IR35 and would like a formal contract of employment from their “employer” client.

A. The status of employees and the benefits of employment over self-employment:

So you're a one-person limited company. You receive income via your company, from the money that the company receives from invoicing clients for work done by you on behalf of your company. The way in which you receive this income, and the way it is taxed, will depend on your status within the company, and (of course) whether you are caught by IR35 and are seen as working direct for the client rather than your company.

It is likely that you will receive income from your company through one or more (possibly all three) of the following ways:

- As a **SHAREHOLDER**, who may receive the benefit of any **DIVIDENDS** that the company pays;
- As a **DIRECTOR**, who may receive the benefit of any **DIRECTOR'S FEES** which may be payable under the Articles of Association (although this is not so common); and/or
- As an **EMPLOYEE**, who may receive remuneration by way of **WAGES** or **SALARY**.

PCG members who receive income as an employee of their company or their client should bear in mind that payments of wages and salary are subject to the deduction of Income Tax and National Insurance contributions.

If a company pays remuneration by way of wages or salary to the employee, then the company will normally be obliged to deduct the Tax and National Insurance payable at source under the PAYE scheme.

You should seek advice from your tax accountant on the most tax-efficient method for you (and your company) to receive income.

If the Inland Revenue considers that you are an employee of your client, then you may wish to consider all of the benefits of employment.

Whilst the tax situation may not be as favourable as being self-employed, being an employee gives you certain statutory rights against your employer. For example, you should obtain the



benefit of the right to the statutory minimum annual paid holiday, minimum daily and weekly break periods, and a limit on your maximum working week. You may during your time as an employee also benefit from maternity rights, parental leave rights, and the right to statutory sick pay.

After qualifying periods of service, you gain the right to a statutory redundancy payment if you are made redundant (with two years' continuous service), and not to be unfairly dismissed (after one year's continuous service). There are also statutory minimum periods of notice, which can be extended by contractual agreement.

If your contract of employment is with your own company, your company should take out Employer's Liability Insurance and will need to consider its Health and Safety obligations, and indeed all its statutory obligations as an Employer. We can provide further advice on these matters if required.

B. Clarifying the relationship between employer and employee:

Some PCG members feel the need to become employees of their own one-person companies, arguing that if Jo Bloggs is found to be an employee of Jo Bloggs Ltd, then Jo Bloggs cannot be an employee of BigCo plc, which Jo Bloggs Ltd is contracted to carry out work for.

The advantage is that with a properly drawn contract of employment between Jo and her company, and a properly drawn contract between her company and BigCo plc, the Inland Revenue will be hard pressed to suggest that she is in fact an employee of BigCo plc and that IR35 applies to her.

The downside to this of course is that all income Jo receives from her company as an employee will be subject to tax and national insurance as any other employee would be liable for.

Under IR35, the Revenue will look at the reality of the situation, and if that reality is that Jo is effectively solely carrying out duties for BigCo and is for all intents and purposes an employee of BigCo, then the fact that Jo has a contract of employment with her company will make no difference to the assessment. The point of IR35, is as you are aware, to cut out Jo Bloggs Ltd if this is merely being used as a vehicle for tax and National Insurance avoidance by those who by any other test are "employees" of their client.

C. Essential features of contracts of Employment:

Contracts of employment may be written, verbal, made through practice and custom or implied. The best position to be in is where both parties are working under a written contract of employment.

As almost every employee's terms and conditions are unique, it is not possible to provide a series of precedent clauses to cover every situation.

However, every employee has a statutory right to receive a written statement of the main terms and conditions of employment within two months of their starting work for an employer.

Any contract of employment that an employer provides must therefore contain as a minimum terms and conditions covering the following matters. Basic example clauses are included (where applicable) for illustrative purposes only. These may not be applicable to an individual employee's situation and you are recommended to take specific advice on these matters.

1. Names of employee and employer:

Addresses should also be included, and in the case of a Company, the registered office should also be provided.

2. Date when employment began (and when continuous employment began):

For example:

- 2.1. The Employee's employment with the Employer [begins/began] on [date].
- 2.2. The Employee's period of continuous employment (for statutory employment rights purposes) with the Employer [begins/began] on [date]. No previous employment or work counts towards the Employee's continuity of employment.

The continuous period of employment is important for determining which rights the employee enjoys at a particular moment in time. This is covered above.

3. Scale, rate and intervals of payment:

For example:

- 3.1. [The Employee will be paid at the rate of £[amount] per hour [[irrespective of the number of hours worked]/[and insert overtime details]]. OR [the Employee's salary is £[amount] per annum [and insert overtime details]].
- 3.2. Payment will be made in arrears every [week/month] by [cheque/transfer directly to the Employee's bank account] on [day of week/date of month].

4. Normal hours of work:

For example:

- 4.1. The Employee's normal hours of work are [time] to [time] on Mondays to Fridays.] and [any weekend work].
- 4.2. [The Employee is, in addition to the above, required to devote whatever additional hours are reasonably required or reasonably necessary for the proper performance of the Employee's duties.]

As the Working Time Regulations now regulate the taking of breaks during work, daily and weekly rest, shift work and maximum weekly hours, advice should be sought on the drafting of clauses for individuals with unusual working patterns, long hours of work or shift work.

The general rule is that for most workers, an employer may not permit an employee to work more than 48 hours per week on average over a particular reference period (usually seventeen weeks). An employer may be breaching health and safety obligations and could leave itself open to prosecution if it does so.

It is possible for employees to opt-out of the 48-hour average week, providing the employee *voluntarily* chooses to do so in a written agreement, which may be terminable by the employee at any time on up to three months' notice to the employer.

If an employee wishes to opt-out, one way to deal with the opt-out agreement is to include a particular opt-out clause in the employment contract. The following is an example of such a clause:

- 4.3. Due to the nature of the Employee's work, the Employee may be required to work more than 48 hours in a week averaged over a Reference Period. By signing this document the Employee agrees to work for more than an average of 48 hours per week averaged over a 17-week Reference Period. The Employee's agreement to exceed this average will apply for as long as the Employee remain employed by the Employer,

unless the Employee withdraws it by giving 3 months' written notice to the Employer. The first Reference Period [begins/began] on [date] and [subsequent Reference periods will be each successive [17/26 week period]]/ [there will be a rolling [17/26 week Reference Period].

5. Entitlement to holidays, and whether this includes public holidays, and holiday pay, and any provisions for accrued holiday pay on termination:

For example:

- 5.1. The Employer's holiday year runs from [e.g. 1st January] to [e.g. 31st December]
- 5.2. The Employee is entitled to [number] weeks' paid holiday per year, in addition to all statutory public holidays.
- 5.3. On the termination of the Employee's employment, the Employee will be entitled to be paid for holiday accrued pro rata in the year and not taken.

The Working Time Regulations specify that most workers are entitled to a minimum of four weeks' paid annual leave (which may be inclusive of statutory bank and public holidays), and that save in the event of termination of employment, holidays may not be paid in lieu.

There are several other matters that should be considered in connection the taking of holidays, and specialist advice should be sought in drafting any holiday clause.

6. Terms governing absences for sickness and injury, including any provisions for sick pay:

For example:

- 6.1. Should the Employee be absent from work due to sickness injury or any other reason, the Employee will be paid only the Statutory Sick Pay to which [he/she] may be entitled at that time.
- 6.2. The Employee must ensure that [his/her] manager is notified by 9.00am or as soon as possible thereafter of the absence and its likely duration, and must keep [him/her] informed on the Monday morning of each subsequent week throughout the absence.
- 6.3. The Employee must produce a doctor's medical certificate for all periods of absence of more than seven days to qualify for Statutory Sick Pay.

Employers may wish to offer a contractual sick pay entitlement in addition to statutory sick pay, and also will need specific rights in the contract should they wish to have the employee

medically examined (which is important if the employee is off sick for a long period), and access to his or her medical records. Night workers may require health tests under the Working Time Regulations. All these matters require specialist drafting. Statutory Sick Pay is also complicated – you may need to include provisions stating what the “qualifying days” of the week are for SSP purposes.

7. Any Pension arrangements or Pension Schemes:

If no pension arrangements are applicable, a suitable clause may state simply:

- 7.1. The Employer does not operate a pension scheme and a Contracting-out Certificate is [not] in force in respect of the Employee’s employment.

If there is a company pension scheme, once again specialist drafting would be required.

8. Notice from either side to terminate the contract, and normal retirement age:

A clause reflecting the statutory minimum periods of notice an employer must give to an employee might read as follows:

- 8.1. During the first four years of employment the Employee will be entitled to receive one week’s notice to terminate [his/her] employment. Thereafter the Employee will be entitled to receive one week’s notice for each year of continuous employment up to a maximum of 12 weeks after 12 years’ continuous employment.
- 8.2. The Employee will be required to give [period] notice of termination from the outset.
- 8.3. The Employee’s employment will terminate automatically on [his/her] reaching the retirement age of [age].

Other specific matters regarding notice (such as the option of the employer making payments in lieu of notice), then specific clauses should be drafted.

The employer may also wish to include a “garden leave” clause in the contract, and other provisions for different notice periods in situations such as long-term incapacity (see below).

9. The job title or a brief description of duties:

For example:

- 9.1. The Employee is employed as [job title] [and your job description is attached].
- 9.2. In addition to the normal duties associated with this post, the Employee may be required to carry out additional or alternative tasks from time to time.

10. Termination date (if fixed-term contract):

For example:

10.1. The Employee's employment with the Employer is for a fixed term and ends on [date] unless the contract is terminated at an earlier date in accordance with the provisions on termination set out [above/below in the contract].

There are dangers for employer seeking to terminate fixed term contracts before their term ends. If you would like to employ someone on a fixed term basis, you will need to discuss with us suitable clauses.

11. Details of the place of work:

For example:

The Employee will be required to work at the Employer's premises at [address].

If the Employer expects the employee not to work at one site but a number of sites, specialist drafting will be required (see further below on "mobility clauses").

12. Details of any Collective Agreements which may apply to the contract:

It is most unlikely that Collective Agreements will apply to employers with small workforces or where there is no Trade Union influence.

D. Other Clauses commonly found in Employment Contracts:

As a matter of good practice the following should also be dealt with in a contract of employment. However, clauses covering these matters would require specialist drafting:

- A clause allowing the employer to vary the place of work ("mobility clauses"). However, these are subject to tests of reasonableness. If not included, the employee can refuse to work at any other site than the place of work specified. Bearing in mind that clause must be reasonable in the circumstances of the individual employee to be enforceable, the skeleton of a mobility clause might read as follows:

"The Employee will be required to work at sites on which the Employer is carrying out work, or such other locations in [location, e.g. Staines/Wales/United Kingdom/Europe] as the Employer may from time to time require."

- Clauses detailing any other employee benefits or schemes, such as company vehicles, death in service benefit, private medical insurance, permanent health insurance, bonus and commission schemes, dial cards, and payment of expenses or expense accounts.
- A clause to cover the situation where an employee is off sick for a long period, dealing with how the employee might be dismissed on the grounds of lack of capability.
- Examples of gross misconduct for which the employer may terminate the employment without notice.
- A clause to prevent the disclosure of confidential information of the employer both during and after the employment.
- Clauses covering the position of ownership where intellectual property is created by the employee during the course of his employment (such property often by operation of law becomes the employer's property).
- If the employee is also to be a director of the company (which will often be the case where a PCG member seeks to become an employee of their one-person limited company), a director's service contract may need to be drafted to cover the individual's dual roles of director and employee. Directors have additional duties and obligations towards the company, which means that their contracts may have to be specially drafted in the form of a Deed. We have not provided a precedent director's service contract because each service contract needs to be tailored to meet the particular circumstances of the director/employee. For example, there are several different ways of dealing with the termination of the directorship in the event of termination of employment (and vice versa). It may also be necessary to consider the company's Articles of Association.
- Health and safety obligations of employer and employee (e.g. No smoking policies)
- The procedure in the event of the employee having a grievance about their employment (which may have contractual effect).
- The employer's disciplinary procedure (which may not have contractual effect).
- The following clause may be particularly useful for a PCG member entering into a contract of employment with their own company:

"The Employee may be required to work for other companies or businesses as directed by the Employer but will continue to be employed and paid by the Employer, although

subject to the day to day direction and rules of the Employer/business for which the Employee is working.”

- Details of any Contractual Redundancy Scheme, which like Pension Schemes, are a highly specialist area
- Clauses that restrict the ability of the employee to work for competitors or solicit or take the customers or employees of the employer for a particular period after the contract has been terminated. Such clauses, like “handcuff” clauses, are usually void and unenforceable by an employer, unless the employer can show that the clauses go no further than is necessary to protect the employer’s legitimate business interests, and are reasonable in the circumstances of the employer and the employee. Once again, the use of a specialist employment lawyer would be required to assist in the drafting.

Finally, both parties should sign the contract, with the employee confirming that they have read, understood and agree all the terms and conditions contained in the Contract.

There are also terms implied in every employment contract by common law and statute. For example, the employee has an implied obligation of good faith and fidelity towards his employer, and must not without consent work for competitors during employment with the employer.

E. Agreeing Terms and Conditions

There are many advantages to being an employee (although often not financial!). If however you believe that you are caught by IR35 and will be taxed as an employee, you will want the protection and benefits that employees’ rights bring.

What should be clear from this guide is that the length and content of contracts of employment can vary considerably, almost every employee’s circumstances (and therefore contracts) will be different, and specialist drafting will be required to ensure the protection of employees’ (and employers’) rights. As there are statutory minima relating to many clauses in contracts, advice may be required to ensure that the clauses drafted are not unenforceable in law.

PCG members wishing to enter into employment contracts directly with their clients will have to negotiate with their clients on specific terms. It may be difficult for employees to negotiate better terms than their client’s employees, as the client may well have a standard contract of employment that it will insist on using.



We can provide advice on employees' rights and obligations, and a full drafting service for director's service contracts, general contracts of employment, or simple statements of terms and conditions that comply with the statutory minimum requirements.

Email: j.parry OR c.pallot@bevan-ashford.co.uk

www.bevan-ashford.co.uk/employment

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