



written **by** freelancers **for** freelancers



Expert Briefing on IR591

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SECTION ONE: EXECUTIVE SUMMARY

1. Introduction

In his Pre-Budget Report of 10 December 2003, the Chancellor of the Exchequer announced that his Budget of 17 March 2004 would contain "specific proposals ... to ensure that the right amount of tax is paid by owner managers of small incorporated businesses on the profits extracted from their company". It is probably safe to assume that "the right amount of tax" means "more than is charged at present".

Further detail has not been forthcoming; quite possibly because at the time of writing the precise implementation is yet to be determined. The most likely options are some form of National Insurance on dividends paid either from close companies or some other (newly defined) subset of companies ("owner-managed companies"); removal of the dividend tax credit; insistence on a "market rate salary"; ignoring certain companies for tax purposes; or the withdrawal of the 0% corporation tax band.

This document has been prepared as a technical briefing covering the most likely alternatives, together with advice on mitigating actions in each scenario. It also contains a statement of PCG's position on the measure, inasmuch as any position is possible where details remain unannounced. In summary, the PCG's stance is that a full consultation should occur before details of this policy are decided; incorporation is not tax avoidance and should not be regarded or treated as such; even the most "benign" implementation represents a burden which will potentially mean the closure of tens of thousands of small UK businesses.

This guide is aimed at informed freelancers¹ and their professional advisers; a (very) basic knowledge of personal and corporate taxation is assumed. The principle of "caveat emptor" applies: this document does not constitute legal advice and neither any contributor to it nor the PCG are liable for any consequences of any actions taken after reading it.

PCG remains in close contact with the Inland Revenue and will be meeting with senior officials shortly after the Budget itself. An updated version of this paper will be made freely available at that time to all those entitled to this version of it.

¹ PCG uses the word "freelancers" generically to denote contractors, consultants and self-employed freelance workers in all sectors.

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SECTION TWO: THE PRESENT SYSTEM

2. Background

HM Treasury published its Pre-Budget Report 2003 on 10 December 2003, to coincide with the Chancellor's Pre-Budget Statement to the House of Commons. Chapter Five of the report, entitled "Building a Fairer Society", contains a paragraph indicating its intentions to introduce new measures in the 2004 Budget aimed at ensuring that the "right amount of tax is paid by owner managers of small incorporated businesses on the profits extracted from their company."

Incorporated businesses currently account for income in two different forms which, it is argued distorts business strategies and possibly enables reductions by tax planning, of individuals' tax liability.

The two different forms are:

- Earned income - this income is treated as usual with National Insurance payable at published rates.
- Dividend income - most small businesses take a large proportion of their profits as dividends, which has been advantageous as there is no national insurance on them.

The issue can be illustrated by the following table (note that the CT figures assume that a salary of £4,615 drawn):

Tax/NI liability, self-employed versus incorporated, per year²

	(1) Self- employed	(2) Incorporated	(3) Incorporated no 0% rate ³	(4) Self- employed	(5) Incorporated	(6) Incorporated no 0% rate
Pre-tax profits	£15,000	£15,000	£15,000	£30,000	£30,000	£30,000
Income tax	£2,050	-	-	£5,350	-	-
National Insurance	£104 (Class 2)	-	-	£104 (Class 2)	-	-
	£831 (Class 4)			£2,031 (Class 4)		
Corporation tax	-	£91	£1,973	-	£3,654	£4,823
Total tax and NI	£2,985	£91	£1,973	£7,485	£3,654	£4,823
Net income	£12,015	£14,909	£13,027	£22,515	£26,346	£25,177
Total tax and NI as % of profits	19.9%	0.6%	13.2%	25.0%	12.2%	16.1%

² Institute of Fiscal Studies, Green Budget, 2004

³ These figures are based on a system where the 19% corporation tax applies to all taxable profits up to £300,000

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The full text of paragraph 5.91 of the Pre-Budget Report 2003 is as follows:

5.91 The Government has introduced a range of measures and targeted tax reductions to support small businesses; including through reform of capital gains tax, reducing the rate of corporation tax for smaller companies and the introduction of a zero rate, Stakeholder Pensions, and the abolition of advance corporation tax. These measures are encouraging the creation of more small companies, including through self-employed people incorporating their businesses. The Government is keen to ensure the measures it has introduced provide support for these firms taking on the opportunities and responsibilities involved in that transition, and to encourage them to reinvest their profits and grow their businesses. At the same time, the Government is concerned that the longstanding differences in tax treatment between earned income and dividend income should not distort business strategies, or enable reductions by tax planning of individuals' tax liability, and that support should continue to be focused on growth. **The Government will therefore bring forward specific proposals for action in Budget 2004, to ensure that the right amount of tax is paid by owner managers of small incorporated businesses on the profits extracted from their company,** and so protect the benefits of low tax rates for the majority of small businesses.

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3. Differences between incorporated and unincorporated businesses

3.1 Disadvantages

3.1.1 High burden of compliance: cost, time, complexity and penalties

A number of returns need to be made, all of which attract penalties and which, in general are significantly heavier than those on an unincorporated business, if they are not filed within a strict time limit. They include:

- Corporation tax return
- Accounts
- A separate computation of taxable profits
- Details of loan account transactions
- Form P35 in relation to proprietor's remuneration
- A form P11D (return of taxable benefits and expenses) for each director
- No reporting is needed by the company in respect of dividends but the shareholder needs to include it on his tax return.

The reporting requirements - and penalties for getting it wrong - are far less for an unincorporated business. This can be a very important factor for a small business, particularly a one-man business, where the proprietor is devoting perhaps 40 or 50 hours a week to servicing customers and has neither the time, nor in many cases the ability, to grapple with tax forms and the business does not have the funds to engage someone to do it. All of the reporting requirements for the unincorporated business can be dealt with together after the year end (other than VAT returns) with a significant cost saving. PAYE for the small unincorporated business can be an additional problem.

3.1.2 Payment of tax on money withdrawn from business (salary or loan) even if trading losses

Small businesses are not normally financially sophisticated and often do not have reserves. The proprietor tends to simply draw from the business bank account the money that he needs to live on, rather than starve, irrespective of the legal structure of the business. When a small business makes losses incorporation therefore creates a double whammy. At the time when the company is desperate for funds to survive, money that the proprietor needs for living expenses must either be taken as earnings and taxed at his marginal rate - with the company getting a tax deduction only if and when it reaches profitability - or left as a loan and taxed at 25%. With an unincorporated business there is no tax charge at all on such necessary drawings.

Excess drawings do not cause significant problems with an unincorporated business. In an incorporated business section 419 imposes a higher effective tax rate than on earnings.

3.1.3 Loss on trade cannot be offset against other income

3.1.4 Hard to withdraw capital which has been introduced into a business without tax and/or regulatory issues

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3.1.5 CGT penalties when selling assets

The company has to pay tax by reference to the increase in value of its goodwill, property and other assets, and the shareholder then has to pay tax again on the increase in value of its shares (which are now more “valuable” because of the notional gain on sale of the assets).

3.1.6 Early payment of tax and NICs on salary compared to profits

PAYE and employee/er NICs are usually paid monthly, CT and income tax on profits for sole traders have longer payment periods

3.1.7 Corporate debt, FX and Forex rules apply

3.2 Advantages

Although the list of advantages for having a company is longer, many of these items apply to only a small number of companies. The disadvantages apply to most.

3.2.1 Limited liability

3.2.2 Corporate vehicle may mean outside loan finance is easier to obtain

3.2.3 Retained profits taxed at a low rate of within company

A small company pays corporation tax on retained profits and pays further tax/NICs only when paid out. Thus the company can reinvest in the business more tax-efficiently than the sole trader.

3.2.4 Outside investors can take a share of the company easily

3.2.5 Owner managers can obtain SSP and SMP and similar benefits

Note: 10% per cent of SMP is paid to small employers, so the owner managed company can claim the cost back from the Government with a 5% margin. As the cost is borne by the company and then recovered, the margin remains within the company. Sole traders cannot claim SMP.

3.2.6 Entitled to R&D tax credits

3.2.7 Spread personal tax on profits by timing of withdrawals

Note: Thus a corporate business which had a two good years followed by a fallow year could pay out the profits as salary/dividends over three years and utilise the manager’s lower rates of personal tax. In contrast, the sole trader would be taxed in full in the two years. Reliefs only become available if the business is loss making, when the sole trader regains the advantage of greater flexibility.

3.2.8 Can claim tax relief on amortisation of intangibles eg goodwill

3.2.9 Raise funds through EIS/VC schemes

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3.2.10 Can have occupational pension scheme and NIC relief for pension payments

Note: This can be a major advantage for the small company. Working through a company allows access to more tax-efficient pension vehicles than those available to individuals, including sole traders and partners. Small companies can use either a Small Self Administered Scheme (SSAS) or an Executive Pension Plan (EPP). Even where a personal pension vehicle is used, company contributions can achieve a useful NIC saving as compared to contributions made by an individual.

3.2.11 Cash available for filing by internet

The number and variety of differences between the self-employed small trader and the corporate business means that changing from one structure to another is not a trivial matter.

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4. IR35 background

IR35 is the “intermediaries legislation” which was announced in the 1999 Budget and came into force in April 2000. IR35 was introduced because the Government believed that some people were providing their services through a limited company or a partnership as a means of avoiding tax. IR35 allows the Inland Revenue to treat fees paid to a company or a partnership as an individual’s personal salary.

Many contractors have been caught up in the legislation and subsequently taken to court. A number of recent IR35 court cases against individual contractors have ruled against the Government, so that the anticipated increases in National Insurance and Tax receipts have never materialised.

IR35 applies to individuals (“workers”) who provide services through a limited company in which they own more than 5% of the shares, or a partnership in which they take more than 60% of the fees (the “intermediary”), to another business (“client”). The legislation allows the Inland Revenue to “look through” the intermediary and determine whether, if there had been a direct contract between the worker and the client, it would have been a contract of employment, in effect of applying the case-law distinction between employment and self-employment to the relationship.

If the relationship is found to be one of “disguised employment”, the fees paid to the intermediary by the client are deemed to have been paid by the intermediary to the worker, subject to PAYE and NICs. A fixed 5% allowance may be deducted from the fee to cover business expenses, irrespective of how much is in fact incurred in expenses, or how much is in fact paid to the worker as salary or in any other form.

IR35 applies only where the consultant is a significant share-holder or partner, which in practice means small companies and partnerships. Large service companies are unaffected. IR35 does not create an actual employment relationship between the worker and the client. The worker gets no employment rights with respect to the client. The intermediary company remains liable for all PAYE and NICs, including employers NICs, on the fees received, and remains liable for holiday pay, sick pay, maternity pay and so forth for the worker.

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5. S660A background

The settlements legislation dates from the 1930s, though its current incarnation is through the Income and Corporation Taxes Act 1988 and some changes in 1995. Its aim is to prevent re-characterisation of one person's income as another person's income for the purposes of avoiding tax. When someone who is married starts in business as a freelancer, the typical structure of that business, on professional advice, is as a limited company with shares partly owned by the freelancer and partly owned by the spouse. The proportion of shares owned by the spouse varies but is often 50% especially where the spouse has no work other than for the business. As with any business, dividends are paid in proportion to shareholding.

Often, the main income of the business derives from the activity of one spouse, who provides specialist services in a particular field, while the other takes an administrative or supporting role, sometimes as Company Secretary, sometimes as assistant with marketing, bookkeeping, general administration; usually some combination of the above.

Recently, the Revenue's interpretation of this legislation appeared to change, and following a request from taxation professionals the Revenue issued Tax Bulletin 64 elucidating its current position.

In general terms, the Revenue considers a freelancer to be a potential target if:

- Their spouse owns shares in their company
- The amounts of money brought into the company by each spouse are not in proportion to the number of shares owned (e.g. if one partner owns 50% of the shares, but earns less than 50% of the fees)
- Dividends are ever declared
- Similar issues relate to husband and wife partnerships.

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SECTION THREE: OPTIONS FOR IMPLEMENTING IR591

6. Introduction

The following are some thoughts on what the Chancellor may do, and of the possible consequences of each. It is of course not a complete or exhaustive list, but is rather a starter-pack of thoughts, in the absence of any information from the government. None of them is a recommendation to action.

One overall theme is common to all these ideas - If the tax and NICs cost exceeds that of working as self-employed, there will be a move back to non-incorporated forms. People will either seek to disincorporate, or (where this is possible) begin another parallel self-employed business.

Even if the cost of both routes is the same, this will happen - other things being equal it is easier to be self-employed than incorporated.

If there is a widespread need to disincorporate, and the current tax regime for disincorporation is unamended, the Government will be pilloried for having enticed people into an expensive and complex company regime from which there is no exit.

It is also reasonable to point out that the current state of affairs (IR35, s660A, IR591) have come about essentially because employees, the self-employed, and owner managers are all taxed and NIC'd differently on their earnings.

A simpler and more radical approach would be to merge tax and NICs and collect it on the same basis from all taxpayers. While it remains possible to arbitrage between the taxation of different forms of work, people will continue to redefine themselves to take advantage of the differentials. The government has to date concentrated on separating the deserving from the undeserving, rather than addressing the underlying cause of the problem.

6.1 Loss of tax credit on dividends paid to owner-managers

- Would narrow the gap at the bottom between the small company and the self-employed business
- But as the profits increase, and thus the CT rate, this route would lead to excessive taxation, so would need to be capped - more complexity
- And the NICs differential would remain
- Issues of (a) retained earnings, (b) liquidations (c) identification of target dividends and (d) identification of population affected: see later parts of this paper
- Plus possible problems with double tax agreements

6.2 Application of Class 2 and Class 4 NICs to dividends

Application of Class 2 and Class 4 NICs to dividends paid by owner managed businesses

- Would give parity with self employed for NICs but only on profits withdrawn.
- Difference between CT rate and value of tax credit means that at low levels of earning there is still an advantage to incorporation
- Would meet the test of simplicity and be seen as narrowing the gap which has opened up with the self-employed

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- Would incentivise retention of funds within the business
- Not too difficult to implement if delay for Class 2 to allow set up times,
- More favourable than IR35 so (largely theoretical) improvement in tax/NICs position for “deemed employees” assuming that IR35 is replaced
- However, as above, issues of (a) retained earnings, (b) liquidations (c) identification of target dividends and (d) population affected: see later parts of this paper

6.3 Class 2 and Class 4 NICs plus withdrawal of tax credits on certain dividends

Application of Class 2 and Class 4 NICs to dividends paid by owner managed businesses PLUS withdrawal of tax credits on dividends at low levels of earnings

- Would give rough parity with self employed but would need managing at the top end
- An overnight increase in tax/NICs of this scale would cause severe problems for some businesses and individuals, see part 6
- Issues as for first option
- Managing changes to corporate tax, personal tax and NICs looks challenging especially in the short term

6.4 Application of Class 1 NICs to certain dividends

Application of Class 1 NICs to dividends paid by owner managed businesses.

- Harsher than Class 2 and 4 (and less easy comparative with the self-employed)
- More difficulties with quick implementation because of the systems issues
- Imposes same NIC charge on the “genuinely self-employed” operating via a company as on the deemed employees identified for IR35
- The former may cease to operate via a company and either disincorporate or set up a parallel business; whether they did so would depend on the cost of this relative to the benefit of a low tax rate. Modelling would need to be done to see at what point the individual was worse off by remaining in the company.
- For those remaining in corporate form, same issues re retained earnings, liquidations, and identification of target dividends and population affected

6.5 Class 1 NICs on certain dividends plus further tax on dividends

Application of Class 1 NICs to dividends paid by owner managed businesses PLUS further tax on dividends (either by withdrawal of credit or in some other form).

- Those affected who were able to operate outside a company would do so.
- An increase in tax/NICs of this scale would cause severe problems for some businesses and individuals if they could not extract themselves, see part 6
- The number of LLPs might grow as clients accepted this as an alternative to the legal protection afforded by a company.
- Other issues as in scenarios above

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6.6 Treat owner-managed companies as tax transparent

Treat owner-managed companies as tax transparent, that is, as if they were sole traders or partnerships.

- Probably impracticable given number of differences and timescale, see part 2 of these notes

6.7 Deemed “market salaries”

Deem a “market salary” to be paid and subject this to tax and NICs, whether or not paid out as salary, as dividend, or retained.

- This is “son of IR35” and would be branded as such.
- It would slow the growth of the business by making it tax-inefficient to hold funds within the business - as they simply create more profits which are then taxed again next year. The canny investor will withdraw and invest elsewhere more tax efficiently - eg in the stock markets.
- To be remotely workable in practice, a fixed percentage market salary would need to be set for all.
- If the tax and NICs cost exceeded that of working as self-employed, there would be a move back to non-incorporated forms. Even if the cost was the same, this would happen - other things being equal it is easier to be self-employed than incorporated
- Assuming that the Government does not want this to happen, the “market salary” percentage would need to be calculated to prevent this - ie to maintain some positive tax/NICs differential with the self-employed. Modelling would be needed at different income levels.
- Would the market salary need to be capped - so that above a certain level there was no requirement to take the money out of the business? This would be on the basis that at higher earnings levels tax is paid in any event and only employer NICs (and the 1% employee NICs) are in point.
- If there was no cap, then there would be no way for a highly profitable business to grow by retaining funds.
- Caveat - it took over a year to get the legislation on IR35 to work technically and even then subsequent amendments were needed in a number of areas, and there remain many unhappily drafted sections. The legislation would have been better if there had been open consultation throughout the process instead of the very limited changes which were accepted.

6.8 Withdrawal of 0% tax rate

- Simplest solution and easiest to implement.
- Probably too much of a political climb down.

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SECTION FOUR: WHO WILL BE AFFECTED?

7. Impact on the small business community

The proposed changes will impact significantly the small business community, defined as comprising those companies with under 50 employees.

Some facts about the UK SME market:

- There are almost 3.8 million small businesses in the UK,
- These firms account for over 99% of the total number of UK firms
- Almost 70% of small businesses have no employees.⁴
- SME's generate 52% of total UK turnover.
- SME's employ 12.6 million people, representing 56% of the private sector workforce.⁵
- There has been a big recent increase in incorporations - up 43% last year, as widely predicted by many, including the Revenue.

Businesses incorporate for a number of reasons:

- They are required to by their client base, which are otherwise unwilling to use them because of the employment risk.
- Incorporation is required for many assignments and especially within the Public Sector.
- In some sectors, incorporation is seen as a signal of a professional organisation
- It is common practice for the accounting profession to encourage incorporation to new businesses as a means of limiting liability.

"There is currently **no precise definition** within current tax legislation of 'owner manager'. This issue is among those being considered by the Government in the context of its announcement in paragraph 5.91 of the 2003 Pre-Budget Report."⁶

7.1 Which payments to whom are caught?

It is unlikely that provisions will affect all payments made to all shareholders in a small business - because that will deter investment and be difficult to dovetail with other government policies.

However, if it applies only to those working in the business then the tax system will explicitly tax more harshly those who work to earn the profits than those who are passive investors in others' businesses.

As the ICAEW has said, "We are not economists. We accept that it is possible that there may be good economic reasons why investment income should be regarded as more beneficial to

⁴ DTI 2003 figures quoted by the FSB

⁵ *Government Action Plan for Small Businesses*, January 2004

⁶ Dawn Primarolo in recent exchange with Michael Jack MP

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the economy than earnings or that surplus funds should remain within a company, usually on bank deposit, rather than being distributed and used either for spending or investment in other businesses. However, we suspect that most people would be surprised if that is the case.”⁷

There are also some difficulties with defining *how much work* will affect the payment. Furthermore, if this were the only criteria, it would not catch the perceived S660A problem of insufficiently contributing spouses.

Thus one should assume that it will cover those working in the business (however defined) and their spouses or life-partners or other family members.

However, as we understand that one of the aims is to bring **composite companies** within the IR591 regime, the definition will have to be amended. Any such amendment will be difficult to define closely without catching other companies with unconnected shareholders.

7.2 The close company rules

The definition of a close company is deceptively simple; however it can be very difficult to apply in borderline cases. A table showing this complexity⁸ is set out overleaf.

Barry McCutcheon has written “The meaning of the word ‘control’ is central to the definition of a close company. One’s understanding of the meaning of ‘control’ for these purposes is partly dependent on one’s ability to bear in mind the extended definition of certain other words and in particular ‘participator’, ‘associate’, ‘relative’, ‘loan creditor’ and ‘director.’”⁹

Although these rules are still on the statute book, they now apply only in very limited circumstances (loans to the owner managers) and their wider use in the apportionment context was abandoned.

If the application of these rules is to be extended, it is certain that most small businesses and their advisers will struggle to understand and apply it.

In addition to the close company rules, further rules define “close investment holding companies” that are subject to further and more restrictive rules. Some such distinction may also be required under IR591.

7.3 Sheep and goats

Will it apply to all types of business, or will there be an attempt to distinguish those with capital from those without. If so, problems of definition come in again? Will it attempt to distinguish those businesses with ‘disguised employees’ from those without, which would merely perpetuate the current problems with IR35?

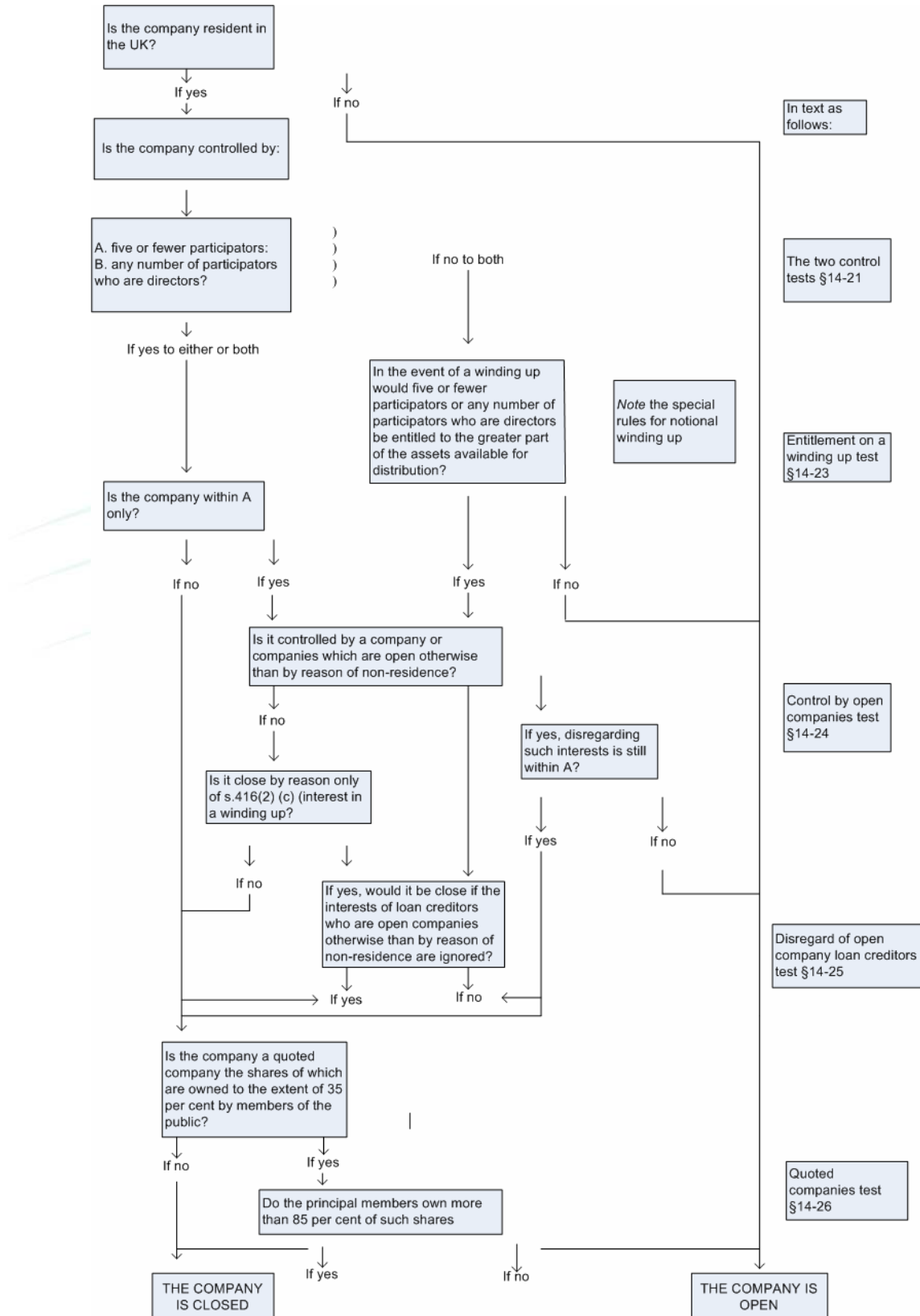
Will the rules apply even where a “market salary” is taken, and if not, how will a market salary be interpreted? If not, there is effectively no financial reward for the small business person of investing his effort as well as his money in the company (in contrast to the business man who simply invests his money).

⁷ ICAEW TAXREP 17/02: Representations on the 2002 Finance Bill

⁸ ICAEW TAXREP 17/02: Representations on the 2002 Finance Bill

⁹ See *Taxation of Companies and Company Reconstructions* at part 14.06.

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Will an attempt be made to distinguish “entrepreneurs” from other businesses, and if so, how? Note that Professor Freedman warns that: “The attempt to distinguish ‘genuine’ small businesses which should attract reliefs and exemptions because they are ‘the engine of the economy’, from ‘non-genuine’ businesses, which are to be denied reliefs, has no basis in logic and seems doomed to failure. It is impossible to know, ex ante, which firms will grow and which will not, and there is no reason why a service provider should be any less ‘entrepreneurial’ in terms of growth than a provider of goods, especially within the new ‘knowledge-based’ economy.”¹⁰

The EU’s Economic and Social Affairs Commission has recently criticised the continuing attempt to distinguish between these types of businesses, saying that “we must avoid unrealistic expectations which are likely to result in disappointment.”¹¹

Similarly, the newly published¹² DTI Small Business Service Action Plan does not classify small businesses into “sheep” and “goats”:

“There are almost 3.8 million small businesses in the UK. They come in many shapes and sizes: from high-growth start-ups to ‘lifestyle’ businesses and social enterprises. Together they account for over 99% of the total number of UK firms and generate 52% of total turnover. They employ 12.6 million people, representing 56% of the private sector workforce. They form part of the bedrock of local communities, contributing to both economic prosperity and social cohesion in towns and in rural areas.”

Will long-standing businesses which have been running in incorporated form for many years, i.e. before the current 0% relief made it so attractive, be treated in the same way as those who have recently incorporated? We assume yes, but the shock for this group will be even greater. If not, there are serious issues about fairness.

7.4 Other issues

What will the position be for employee shareholders (other than those with a managing interest) and how will this be defined?

Also note the problems of subsidiary companies which plagued the opening years of IR35 - the relevant clauses were finally rewritten in ITEPA.

¹⁰ Ibid

¹¹ Quoted by Freedman, op cit.

¹² January 2004

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SECTION FIVE: DRAWING UP AN ACTION PLAN

8. Introduction

Many freelancers are asking for advice about what pre-emptive action should be considered in light of the changes heralded in the imminent Budget. Without knowing the details of how these changes are likely to be implemented, it is impossible to provide meaningful advice.

According to Malcolm Gunn, editor of Taxation, “It is not thought that any change which involves the imposition of National Insurance liability on certain dividends can be brought in with immediate effect, unless the charge is under Class 1A (most unlikely in view of the long delay in collection). Pay-as-you-earn software would require rewriting and the relevant legislation would also need to be on hand. Much the same applies to any re-casting of dividends as remuneration. If, however, changes are made at the corporate tax level, they can be introduced with immediate effect because there will always be apportionments to be made by reference to each company’s accounting period. My advice is that if there are distributable funds in the company, distribute them quickly as possible, even if it means similar amounts going back in by way of loan afterwards.”¹³

8.1 Actions before Budget day, 17 March 2004

At this point the only real action that will possibly mitigate the effects of IR591 is in the case where the implementation is some form of NICs on dividends. If this is the case, and though widely thought to be a likely option it should be emphasised that there is no certainty, then where the profit and loss situation within a company allows it, consideration should be given to paying a dividend that brings the owner up to the bottom of the higher rate band. This will avoid NICs that would otherwise be paid when withdrawing the profits later.

8.2 Actions after Budget day

After Budget day, PCG’s expert team will be evaluating the announcements and their impact on the freelance small business community. It will provide its detailed, expert analysis soon thereafter, and will update this Expert Briefing accordingly.

¹³ Malcolm Gunn, Taxation, published 26 February 2004

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8.3 Disincorporation

Clearly one possible effect of IR591 (depending as always on the implementation chosen) will be large-scale disincorporation, often of those business which, incentivised by the 0% rate and other measures, have only recently incorporated. A detailed examination of the concomitant issues is beyond the scope of this guide, however in brief the key issues include:

- Double CGT cost on assets (including property, goodwill, intangible assets such as franchising rights and contracts)
- Inability to carry forward losses from the company into the new unincorporated business
- Stamp duty issues
- The position of creditors and minority shareholders
- The costs and administrative burdens
- The status of the undistributed profits

Once the implementation is announced, this document will be updated to include a discussion of the implications for those considering disincorporation with particular focus on freelance businesses.

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SECTION SIX: PCG'S POSITION

9. Introduction

A detailed position on the implementation of IR591 is of course not possible at this juncture as it is unclear what the legislation will contain. Notwithstanding, the PCG does have a position on the principles behind IR591 and the manner in which the measure has arisen.

In summary, the PCG's stance is that a full consultation should occur before details of this policy are decided; incorporation is not tax avoidance and should not be regarded or treated as such; even the most "benign" implementation represents a burden which will potentially mean the closure of tens of thousands of small UK businesses. Although the measure is being trailed in some quarters as the end of IR35, it is not clear that this will be the case; what is clear is that far more businesses will be affected by IR591 than merely those at risk under IR35.

9.1 Consultation

A principle objection that the PCG has to the present state of affairs is the lack of consultation with affected parties' representative bodies.

In his foreword to the existing Code of Practice on Written Consultation (issued in November 2000) Mr Blair said:

"We are consulting more than governments ever have in the past. That is welcome in itself. But it means extra work for the people we consult. Their contributions can improve, sometimes transform, initiatives we embark on.

....And as many people have made very clear to us, it means giving long enough for a response.

....Real changes in behaviour are needed here. We have seen examples of excellent consultation. But not always, and I believe we must as a government do better overall.

....I believe the message is spreading throughout the administration that better consultation means better *results*. *My ministerial colleagues and I will continue to work in that spirit.*"

The new code, which is effective from April but has now been published, states that "Consultation is a continuous process that needs to be started early in the policy development process."

The general principles of the current Code of Practice are that:

"the criteria in this code apply to all UK national public consultations on the basis of a document in electronic or printed form. They will often be relevant to other sorts of consultation. Though they have no legal force, and cannot prevail over statutory or other mandatory external requirements (eg under European Community law), they should otherwise generally be regarded as binding on UK departments and their agencies, unless Ministers conclude that exceptional circumstances require a departure.

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We assume that the Treasury must be operating therefore under exceptional circumstances, although we are unclear what these are. The code (at criterion 5) says that “The nature of the problem dealt with may also occasionally mean that urgency is in the public interest, **though real urgency of this sort is rare.**”

Where a shorter period than 12 weeks is, exceptionally, appropriate, then the Code says that we should be told “**Ministers’ reasons for departing from the code**, and what **special measures** - for example advance notice of at least the broad issues covered - have been taken to ensure that consultation is nevertheless as effective as possible.” No such communication has occurred.

The Code says that “The main purpose [of consultation] is to **improve decision-making**, by ensuring that decisions are soundly based on evidence, that they take account of the views and experience of those affected by them, that innovative and creative options are considered and that new arrangements are workable.” This is at the heart of our concern - failure adequately to consult will result in poor legislation.

It goes on to say that “The Committee on Standards in Public Life¹⁴ has drawn attention to the importance of consultation with a wide cross-section of the public, without which the **openness and accountability of Government could be impaired.**”

In addition “Regulatory proposals (including EU legislation) that may create **burdens for business**, charities or voluntary organisations should include a **draft Regulatory Assessment**”. Notwithstanding, the PCG is unaware of any Regulatory Impact Assessment with regard to 5.91, or any plans for one.

Many commentators have come to the view that IR591 will inevitably mean the end of IR35. It is certainly possible, though very far from certain, that this will be the case.

The PCG’s position on IR35 is well known, and clearly we would not mourn its passing, though that does not necessarily imply that we welcome its replacement. In practice few people pay IR35, either because they are well-advised (PCG has a record of several hundred wins to one loss in defending its members against the tax), or because they simply evade it. The costs of deciding IR35 status disputes are significant for both the Revenue and taxpayers.

If IR35 is to go, it is important that the key issues which did form part of the limited IR35 consultation are considered when drafting the implementation of IR591. These include:

- The tax position of clients and agencies;
- The position of overseas registered companies which operate in the UK;
- Interaction with the CIS regime (when first drafted, the subcontractor company which was also within IR35 suffered serious cash flow consequences, with a marginal tax rate of 60%).

¹⁴ www.public-standards.gov.uk/

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9.2 Incorporation is not tax avoidance

Underlying many recent measures (IR35, the new interpretation of S660A and, now, IR591) is an innuendo that those freelancers who incorporate are paying less tax than they ought. The PCG's position is that this is simply not so, though it is clear that the zero tax band has produced a flood of incorporations that would otherwise not have happened.

The debates in the House of Commons at the time the corporation tax rates were cut have been well analysed by Malcolm Gunn in *Taxation*.

He made it clear that there was no expectation that incorporation was to be regarded as tax avoidance; indeed the contrary was suggested:

"The assurance was that the régime was set up to enable long term decisions to be made with confidence. Such confidence turns out to be misplaced. What may be particularly noted from that debate was that the Government was aware at that time that many businessmen on relatively low incomes were being advised to incorporate because the tax system allowed them to minimise their tax liabilities through the medium of a company.

"There was neither criticism from Government ministers about this use of the tax system, nor any remark to the effect that it was considered to be unacceptable tax planning. On the contrary, anyone present at the debate would have come away with the clear impression that the Government was perfectly content with providing this sort of incentive to businessmen and this is confirmed by the remark in the previous year about increasing post tax returns on investments (i.e. shares). Presumably there were perceived to be advantages on both sides; the businessmen could benefit from reduced tax liabilities, partly counter-balanced by increased administrative costs, and the state would benefit by closer regulation of the business concerned."

In the 2002 Standing Committee Debates. Mr Davey set the matter out very clearly:

"The measure will significantly change the tax question of whether to be self employed or to incorporate. To illustrate that point with an example, by setting up a company, a person will be able to pay themselves a personal allowance of £4,615 against income tax, and on top of that to make profits of up to £10,000, which would be paid out in dividends, while facing no tax liability. As a result of the clause, a person who incorporates could earn £15,000 and pay no tax."

He later suggested that perhaps the Government feels that incorporation has extra advantages for the wider economy, but will not disclose what they are. Later in the debate, **Ms Primarolo responded** in the following terms:

"The underlying issue is whether the Government have struck the right balance between incentives to incorporate and to remain unincorporated ... surely small businesses will not look a gift horse in the mouth'."

I do not think it could have been said any more clearly by a Government minister that there were incentives to incorporate; that this was a deliberate policy; that the saving of tax for small businesses by extracting profits in dividends was all part of the strategy. There was no remark about unacceptability, nor was it suggested that the policy was designed to permit no more than the accumulation of an amount of tax-free profit in a company. It was a gift horse and was never 'focused on growth'

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alone as is claimed by paragraph 5.91. Ms Primarolo explained the focus in these terms: ‘to create growth and economic activity and to sustain entrepreneurial activity’. The rules have been set ‘to ensure that the best choices are available, but the choices remain theirs’.

I think it would be fair to say therefore that the comments in paragraph 5.91 of the 2003 Pre-Budget Report have been met with some astonishment. The very corporate tax régime which you yourself have carefully constructed since April 2000 ‘to reinforce the advantages of producing in the UK’ is now described as one which ‘distorts business strategies’ and which ‘enables reductions by tax planning of individuals’ tax liability’, and yet these points were made repeatedly in Parliament and ministers offered no words of warning or adverse comment whatsoever. Furthermore the key difference in the tax treatment of dividends which have given rise to the ‘tax planning’ are not ‘longstanding’ at all. They are the product of your own reforms.”

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9.3 Other government statements

PCG is concerned at the contrast between the manner in which IR591 is apparently to be introduced with other government statements, some of which are reproduced below. The PCG is broadly supportive of the stance adumbrated by these other statements.

“The UK aims to be the best environment for business”¹⁵

“Government is committed to making the UK the best place in the world to start and grow a business.”¹⁶

“The Government has taken action to create an **environment favourable for business** and plays a role in providing opportunities for people to experience enterprise”¹⁷

“Since 1997, the Government has maintained a stable macro economy and introduced a series of measures to make it easier to start up, grow, and run a business. Business taxes have been reduced, regulations have been abolished, and policies to improve access to finance and legislation to promote competition have been introduced.”¹⁸

“But unnecessary or burdensome regulation can also stifle enterprise by removing incentives, and by imposing costs, delays and uncertainties on business. The costs of complying with regulation bear disproportionately on smaller businesses, and therefore divert resources from their business development.”¹⁹

“The push to reduce the administrative and legislative burden on small businesses, and the introduction of a more beneficial and simplified tax regime, have been important elements in ensuring that government meets its objective of building a more supportive business environment which encourages business start ups and growth. The aim has been to reduce compliance costs in general, but also to ensure that small businesses are not disadvantaged in comparison with larger ones, by restoring neutrality of treatment in the fiscal, legislative and regulatory environment.”²⁰

“Government has cut Corporation Tax to its lowest ever level, and is reforming capital gains tax so that it is now one of the most favourable regimes in the world. A number of tax measures targeted specifically on small businesses have also been introduced, such as those mentioned in Chapter 5 which offer tax incentives to support investment in early-stage business affected by shortages of finance.”²¹

¹⁵ Creating an Enterprise Culture, published January 2004

¹⁶ DTI small business website January 2004

¹⁷ Creating an Enterprise Culture, op cit

¹⁸ Ibid

¹⁹ DTI SBS Action plan at page 46

²⁰ Ibid page 48

²¹ Ibid

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“The SBS and the Cabinet Office are working to ensure that all new policies and regulations are designed and implemented in a way that minimises the burdens on small business.” ²²

“The Government’s overall approach is to promote better regulation. This means regulating only where necessary, doing so in a proportionate and targeted way, and reducing bureaucracy wherever possible.” ²³

“The Government is also committed to ensuring that regulation is explained in a straightforward manner so that small businesses find it easy to establish their obligations.” ²⁴

“But economic theory also predicts that regulation can stifle enterprise activity by removing incentives and by imposing costs, **delays and uncertainties on the business...poorly conceived or implemented regulation or taxes intensify market failure by imposing unnecessary costs on small business.**” ²⁵

“The job of government is to do only what it needs to do, no more than what it needs to do - **stability**, a competitive environment, investment in science skills and infrastructure....And at every stage - whether for companies starting up, investing, hiring, training, seeking equity, exporting - **our aim is to be on businesses' side.** Tax: Britain must do more to reward and encourage investment - and we will...I promise we will continue to look with you at the business tax regime so that we provide incentives for investment in wealth creation and greater rewards for success”²⁶

“The *Small Business Research Trust survey (2003)* also found that VAT and employee taxation are the two areas of government regulation and paperwork that take small businesses the most amount of time. Of particular concern is the finding that over 50 per cent of small businesses admit to either reducing the number of people they employ, or avoid employing more people because of worries over the increased burden of paperwork and to avoid further regulation.” ²⁷

²² Ibid page 49

²³ Ibid

²⁴ Ibid

²⁵ Small Business Service- Evidence Paper, January 04, page 71

²⁶ Gordon Brown at the Enterprise Conference on 26 January 2004

²⁷ Ibid

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SECTION SEVEN: EDITORIAL VIEW FROM TAXATION

10. Introduction

In the 26 February 2004 edition of *Taxation*, editor Malcolm Gunn discusses the imminent changes to the tax treatment of owner-managed companies in an article entitled “The Lady Is for Turning!”²⁸

With his kind permission, we reproduce excerpts of his article here.

10.1 Letter to the Rt Hon Gordon Brown MP

After the publication of the Pre-Budget Report 2003, Malcolm Gunn wrote to the Chancellor about the future treatment of close company dividends. The letter was published in the 15 January 2004 issue of *Taxation*. He received the following reply:

Dear Mr Gunn,

Thank you for your letter of 14 January to the Chancellor of the Exchequer about company taxation. I am replying as Minister responsible.

In the Pre-Budget Report the Chancellor said that he would bring forward proposals in the Budget - now to be held on 17 March. I am sure that you will understand that it would be inappropriate for me to comment on the likely shape of those proposals in the period immediately before the Budget.

I will however, give your paper careful consideration over the next few weeks.

Yours sincerely,

Dawn Primarolo MP

10.2 Volte face

As Malcolm Gunn points out, this less than forthcoming response contrasts sharply with a letter that the Paymaster General had written to Mr G Clifton-Brown MP just 16 months earlier, in the summer of 2002, assuaging the concerns of a constituent who had written to him as follows:

Dear Mr Clifton-Brown,

I’m writing to you out of concern arising from my work as a Chartered Accountant in public practice, and in particular, the current tax regime for limited companies and small unincorporated business “sole traders”.

The introduction of the corporation tax 0 per cent band up to profits of £10,000 has made for severe inequality. What it means is that someone making a modest living, in business on their own, has the choice of paying negligible tax and National Insurance if their business is a limited company compared with £2,900 or so as a sole trader. (I enclose a basic calculation.)

As accountants, I think we would be verging on negligent if we did not point this out to our clients, with, of course, a description of the other pros and cons of converting a business to a limited company.

²⁸ Malcolm Gunn, *Taxation*, published 26 February 2004

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I enclose photocopies of an article from *Taxation* magazine discussing some Parliamentary aspects of the situation.

What concerns me is that it seems highly likely, given this Government's track record, that they will wait a while (perhaps the timetable has already been planned) before announcing that "their altruistic measure to help small businesses has been wickedly abused by ingenious accountants". They will then use this to justify punitive new measures, such as charging National Insurance on dividends, or a version of the infamous "IR35" measure.

Contrary to what is implied by those quoted in the *Taxation* article, this country's accountants and tax advisers, like their clients, are struggling to keep up with the flood of new measures and regulation introduced by this Government. I believe very few advisers have the need to go looking for, or creating, extra work!

For many years the struggle over whether workers are "employed" or "self employed" has been fuelled by inequalities in the tax and National Insurance régimes. I'm sure that what everyone would prefer is a fair and level system, subject to recognition of the very real risks and insecurities that those running small businesses live with.

I'm not bothered about a reply to this letter, but I do hope that the Opposition may be able to help prevent the small business community of this country from being ambushed for political, and Treasury, gain as described above.

Ms Primarolo responded on 20 August 2002 to Geoffrey Clifton-Brown:

Dear Geoffrey,

Thank you for your letter of 27 June enclosing correspondence from your constituent ... about recent changes to rates of corporation tax. I am sorry for the delay in replying.

In this year's Finance Act we cut the small companies' rate of corporation tax from 20 per cent to 19 per cent, and the starting rate from 10 per cent to 0 per cent. As a result of the change to the starting rate, companies with profits below £10,000 will pay no corporation tax.

[The reader], who practises as a Chartered Accountant, points out that a self-employed person could save over £2,000 annually in tax and National Insurance contributions by forming a limited company. He is concerned if there is a significant shift to incorporation, the Government may introduce new measures to tax the income of small businesses or their owners.

This Government is committed to reducing, not increasing, the tax burden on small businesses. We want to develop a more enterprising Britain through higher productivity and growth. Recognising that the small firms of today are the big firms of the future, we have, since 1997, introduced a broad and generous package of measures to encourage investment in and by all small businesses.

Cuts in corporation tax have been matched by cuts in capital gains tax. In 1997, all transactions were subject to a 40 per cent rate. From April 2002, capital gains tax on business assets was cut to 20 per cent after one year, and 10 per cent after only two years. Other measures include the introduction of permanent 40 per cent first

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year capital allowances to promote investment, the cutting of the basic rate of income tax to 22 per cent - the lowest basic rate for seventy years - and the introduction of the 10 per cent starting rate. [Further comments followed about VAT reforms.]

Tax is one of several factors that any person running a business would need to consider if deciding whether to incorporate. Some of the relevant factors will be specific to the particular business or individual. As I said during debate in the Finance Bill Standing Committee, our view is that businesses themselves are best placed to assess the relative benefits of different structures, and to decide which is appropriate for them.

We want to help all small businesses thrive and grow. Cutting corporation tax for smaller companies is a targeted and affordable way of supporting growth directly through the tax system.

I hope this explanation is helpful.

Yours

Dawn

10.3 Ad hoc changes to tax system

According to Malcolm Gunn, "The very 'ambush' which the reader feared would take place is now appearing before our eyes. I doubt however whether it was a crafty and cruel trick devised some years ago by the Government. It is more a case of the Government pressing ahead with an inadvisable tax cutting agenda, whilst simultaneously undertaking to spend more money than ever before, as well as offering more direct benefits, covering 6 million families, than ever before. It is now clear that the sums do not add up and something has to be done, no matter how foolish it all looks.

"This is introducing a substantial element of insecurity into ordinary tax advisory work," he continues. "It results in piecemeal announcements on alleged tax avoidance now being issued at the drop of a hat and with instantaneous effect, often without draft legislation being available."

Commenting on examples of such piecemeal announcements, Malcolm Gunn writes, "I predict that more of these ad hoc changes to the tax system will appear out of the blue in the year to come. At any moment, what you thought you could do quite validly will suddenly become targeted as an abuse to be stopped instantly."

Having discussed the example in relation to trusts and taper relief, he concludes, "[In short,] because of the huge pressure on public finances, our tax system is under an unusual level of stress and there is no certainty that anything you can do today, however routine, will be equally valid tomorrow or indeed will remain tax effective in the future. The tax cuts since 1997 were 'to encourage investment in small businesses'; the reversal of them, coupled with the current administration of the tax regime, is making the United Kingdom a treacherous place in which to conduct a business."

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10.4 *Taxation's view of paragraph 5.91*

Malcolm Gunn's view about the implications of paragraph 5.91 is very similar to that espoused by PCG. "We still know very little of what is to materialise as a result of paragraph 5.91," he writes. "Most speculation involves a charge to National Insurance contributions on certain dividends paid by close companies. Whether this would be Class 4 or Class 1 is of course a matter for conjecture, but in either case the complications would be phenomenal. Hundreds of thousands of businesses have been structured under an existing tax regime which is about to undergo a seismic shift. There would inevitably be a whole raft of anomalies. There may be implications for shares held by children's trusts, or held by relatives old and young, cases where there is venture capital input and cases where there is other third party financial assistance which includes a shareholding.

"Another possible change thought to be high up on the agenda is the re-casting of certain dividends as earnings, coupled with a maximum figure for the proportion of distributed income which can be taken as dividend. Again, it would seem difficult to construct this without unfair consequences in many circumstances."

10.5 *Likely outcome and initial advice*

"It is not thought that any change which involves the imposition of National Insurance liability on certain dividends can be brought in with immediate effect," writes Malcolm Gunn, "unless the charge is under Class 1A (most unlikely in view of the long delay in collection). Pay-as-you-earn software would require rewriting and the relevant legislation would also need to be on hand. Much the same applies to any re-casting of dividends as remuneration. If, however, changes are made at the corporate tax level, they can be introduced with immediate effect because there will always be apportionments to be made by reference to each company's accounting period. My advice is that if there are distributable funds in the company, distribute them quickly as possible, even if it means similar amounts going back in by way of loan afterwards."

10.6 *Conclusion*

Given the Government's stated commitment to reducing the tax burden on small business less than two years' ago, the imminent changes are hard to justify, and Malcolm Gunn believes that "... there has been a mistake of colossal proportions, even though it was clearly pointed out by others at the time. The changes previously made were much too sweeping and are now regretted. The fact that a great many small businesses have as a result been led up a blind alley, incurring higher ongoing administrative costs as a result, is just too bad. The representative bodies have argued for disincorporation reliefs to be introduced along with the changes, but they have been told that there is no hope of that. The next best possibility is that there may be a delayed start date for the new régime, given that all the businesses affected ought to have the opportunity to restructure themselves to mitigate the effect of the many anomalies which will undoubtedly arise."

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SECTION EIGHT: APPENDICES

11. Appendix A: PCG background

The Professional Contractors Group (PCG) was formed in May 1999 to lobby against the Government's IR35 proposals. It has since evolved from operating as a single issue group to being a fully-fledged trade association dedicated to protecting and promoting the interests of the freelance community - irrespective of industry focus.

PCG's aim is to work for proper recognition of independent freelancers as a genuine and valuable sector of the economy, generating wealth and employment, providing industry with a flexible workforce. PCG is a not-for-profit organisation run by freelancers for freelancers, and is committed to promoting members commercially and supporting their development. PCG now represents some 11,500 freelance businesses that pay an annual membership subscription.

PCG has worked with Inland Revenue to improve its employment status manuals (ESM), and more recently with DTI to ensure the inclusion of an opt-out clause for freelance contractors in its new agency regulations. It also sits on the IT Skills Panel for Work Permits UK, and has advised about measures to counter Intra-Company Transfer (ICT) abuses, as well as clearing the IT Skills Shortage list and ensuring that agencies would be refused permission to issue work permits.

PCG represents freelancers at various meetings of the All Party Parliamentary Small Business Group (APPSBG) and the International Labour Organisation (ILO), and works closely with various unions such as Amicus and UNIFI to discuss issues of common concern.

PCG is now increasingly perceived as The Voice of Freelancers and receives regular invitations from the Government to participate in consultations on a number of topics. PCG's two-year collaboration with the DTI, for example, was rewarded by an opt-out clause in its new agency regulations. This means that self-employed freelance contractors may opt out of the new regulations, and can choose to pay agencies to market their skills on their behalf. This represents a significant victory for PCG on behalf of the freelance small business community.

PCG offers the most comprehensive source of IR35 advice, guidance and tools. Its legal cover has saved members an estimated £4 million in professional charges and taxes since its inception. 421 tax status cases have so been concluded, all of them successfully, with the exception of just one where the member involved settled with Inland Revenue.

A wealth of advice and guidance is available to members, on topics ranging from tax issues such as IR35 and Section 660, to providing general guidance about being in business as a freelancer, including the provision of draft contracts. Via the forums, members and affiliates have access to an enormous store of knowledge and information about legal, accounting, taxation, marketing, technical, press and a host of other matters. The commercial forum facilitates the promotion of members' goods and services to one another. Other member benefits include discounts on insurance, accountancy, books, office support and hotel accommodation.

PCG recognises the contribution of a wide range of stakeholders in the freelance marketplace, and invites them to join the PCG as Affiliate members, allowing them privileged marketing access to its full members, who are freelancers in IT consulting, management consulting, accounting, engineering, oil and gas, interim management, marketing communications and several other sectors.

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12. Appendix B: Retained profits, liquidation and apportionments

12.1 Retained profits and apportionments

The imposition of income tax and/or NICs on certain undistributed profits is not indicated by 5.91, but the consequence of not including such a provision will be that those who can afford not to pay out their profits (because, for instance, they have other income, or a working spouse) will pay less tax than the person who is working for his living.

The following page describes (for those who have forgotten or are too young to remember) some of the difficulties caused by close company apportionment. In brief, there were two big problems with apportionment for trading companies. One was the complexity of computing the income that could be subject to apportionment. The second was protracted correspondence on what money needed to be retained for the “requirements of the company’s business”.

As Professor Freedman succinctly says of these rules: “They were complex and unworkable and were repealed.”²⁹

12.2 Liquidations

If there is no anti-avoidance legislation, then some companies will collect their income and distribute it on liquidation, so benefiting from CGT treatment and not income tax/NICs. Since it seems unlikely that this obvious loophole will be overlooked, more complex legislation is likely, which will seek to identify those profits which fall within the IR591 regime and those which do not (such as gains on sale of capital assets).

The Revenue’s current view is that a close company in liquidation is normally a close investment holding company:

“A company in liquidation is normally a Close Investment Holding Company. This is because a company in liquidation exists for the purpose of winding up its affairs and distributing its assets to shareholders. Although during the winding up the company might carry on a trade or business that it had carried on previously, it is unlikely that this will be other than incidental to its main purpose of winding up its affairs.” (IR Tax Bulletin, May 1992)

The consequence of this is that the company does not qualify for the small companies’ rate. However, if there are to be more profound and sweeping consequences of being held to be a close company, the CIHC rules are also likely to get a new lease of life.

²⁹ *Small Business Taxation: Policy Issues and the UK* by Judith Freedman, KPMG Professor of Tax Law, University of Oxford

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12.3 Close company - apportionment of undistributed income

Broad Outline: The basic rule was that the income of a close company for an accounting period could be deemed to have been distributed to the participators if its 'relevant income' (see below) which included certain annual payments and interest, exceeds its distribution (see below) for that accounting period. The amount to be apportioned is the '**excess**' and Income Tax could then be charged by the Revenue as if the participators have been paid a dividend.

12.4 Income tax consequences

Any sum apportioned to a participator was grossed up at the basic rate of ACT applicable (except where the apportionment is of interest or annual payments); and

- Was treated as having been received by him at the end of that accounting period and as the highest part of an individual's total income; and
- Was treated as having borne Income Tax at the basis rate but such tax was not repayable.

Amounts less than £1,000 or if lower, 5% of the total amount apportioned were not assessed.

12.5 Relevant Income

Trading company: The relevant income of a trading company was the smaller of

- So much of its distributable income for that period can be distributed without prejudice to the requirements of the company's business; and
- The 'distributable investment income' plus 50% of the net estate income (defined as income other than trading income).

Other companies: The relevant income for a company, other than a trading company, was:

- The amount of distributable income (including trading and estate income) without prejudice to the company's business activities; and
- Any distributable income other than estate or trading income.

12.6 Distribution

For an accounting period, the distribution comprised:

- Any dividend, which were declared in respect of the period and were paid during the period or within a reasonable time (18 months) thereafter.
- All distributions made in the period except the dividends declared in respect of an earlier period.

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13. Appendix C: PCG Survey

Within a week of the Pre-Budget Report 2003 being published, PCG had launched a dedicated website at www.ir591.org.uk, where it invited visitors to respond to an online survey. This had been constructed using SurveyMonkey software, and was set up to allow only one response per respondent, with the identities of respondents not being tracked.

As at 22 February 2004, 496 people had responded to the survey, of whom:

- 414 described themselves as freelancers or people thinking about freelancing
- 25 were accountants or advisers
- 22 were employers

241, or around 48%, of respondents were PCG members. 387 operated through limited companies of up to two people, and 50 operated through limited companies with more than two people.

Asked to what extent they agreed with each of the following statements, respondents answered as follows:

	Disagree strongly	Disagree	No opinion	Agree	Agree strongly
The Government has introduced a range of measures and targeted tax reductions to support small businesses.	186	119	31	50	8
Government taxation policies seem to favour large businesses over small.	7	14	47	119	208
The Chancellor consults the small business community.	244	109	28	7	7
The Chancellor misled businesses by encouraging them to incorporate to take advantage of reduced rate corporation tax bands.	12	15	108	118	139
Further tax increases will stifle entrepreneurialism.	12	11	17	92	263
The Government is right to want owner managers of small incorporated businesses to pay the right amount of tax on their profits.	63	80	68	152	31
I am sure that the rules will be clear and simple so that ordinary people will be confident in understanding them without specialist advice.	279	92	9	10	3
I believe that enforcement will affect genuine evaders only and will not be damaging to other businesses.	243	114	16	10	9
I foresee that overall the complexity of the tax regime will be significantly increased.	14	22	18	107	229
I am certain that the Government will ensure that the measures are implemented fairly for all sectors large and small.	260	110	13	6	4

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The overwhelming consensus from respondents was that PCG should:

- Engage in consultation with officials and ministers at HM Treasury and the DTI.
- Lobby Members of Parliament.
- Continue to foster relations with unions whose members may be affected.
- Form partnerships with other small business associations and special interest groups.
- Seek advice from the best legal tax and accountancy experts.
- Facilitate internal communication and debate via the IR591 web site and PCG forums.
- Address as a key issue at regional seminars.
- Inform and update via the newsletter.
- Once the proposed measures are fully understood organise a petition if appropriate.

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14. **Appendix D: Acknowledgements**

Anne Redston, tax partner at Ernst & Young

Malcolm Gunn FTII, TEP, editor, Taxation

The Institute of Chartered Accountants in England & Wales (ICAEW)

The Chartered Institute of Taxation (CIOT)

The Federation of Small Businesses (FSB)