

Tax Matters

An overview of IR35 and S660A

Protecting and promoting the interests of consultants, contractors and freelancers

Are you on the right side of IR35?

The so-called “IR35” legislation, announced in 1999 and in force since April 2000, seeks to tax freelance workers as if they were employees. Its stated aim was to prevent employees setting up a company and performing their usual job through that company with the resulting tax advantage, and also to prevent companies from forcing their staff to do so. The measure was so broadly drafted, however, that many legitimate contractors are wrongly deemed to be “disguised employees”.

IR35 allows HM Revenue & Customs (HMRC) to “look through” the freelancer’s limited company and treat the fees paid to it as the freelancer’s salary, on which PAYE income tax and NICs are then payable. Only a five per cent allowance for expenses is made and no allowance for the cost of the freelancer’s training, holiday pay, sick pay etc is made at all, even though IR35 does not oblige the freelancer’s “employer” to provide these benefits.

An IR35 investigation usually begins as a PAYE Audit. These are routine checks made on any business with a payroll to ensure that it is operating PAYE correctly. Experience has shown that, for freelancers, they often turn into full-blown IR35 investigations.

Once this happens, the freelancer’s contracts will be closely examined to determine whether or not they create a relationship that amounts to “disguised employment”; this will depend on whether or not the contracts meet certain legal criteria.

PCG’s protection against IR35

The Professional Expenses Insurance that comes as standard with PCG membership covers the professional fees of leading experts throughout any IR35 dispute.

PCGPlus membership includes all the benefits of standard membership plus PAYE Audit Cover. PAYE Audit Cover includes support in preparing all the responses and letters required by HMRC, saving you considerable time and effort and offering excellent chance of an early conclusion. It covers advice, support and representation costs up to and including a hearing at the Commissioners. PAYE Audit Cover also provides cover for the Contract Review process that the IR may instigate to look at the IR35 status of a company.

PCG’s Guide to IR35, available to members only, includes full background information, details of the current legal position of IR35, tips on how to minimise your exposure and details of the key factors that determine whether or not IR35 applies.

Membership also gives you access to free tax and legal helplines, standard contract templates, discounted professional indemnity insurance and access to legal advice and support from other freelancers via the members forums.

PCG and IR35: the fight goes on

PCG initially challenged IR35 with a judicial review. Although sympathetic, Mr Justice Barton ultimately found for the Government. Subsequently PCG adopted a case law strategy, supporting significant cases through the courts in order to achieve greater clarity over what factors place a freelancer inside IR35. While it remains uncertain, complex and confusing, PCG’S efforts have made the issue much clearer than it was five years ago.

PCG and its Affiliates maintain a superb record in fighting IR35, with almost 900 cases won so far and only three lost.

PCG remains the only organisation putting the views of freelancers to Government and continues to lobby for the abolition of IR35 and its replacement with arrangements that meet its original stated aims.



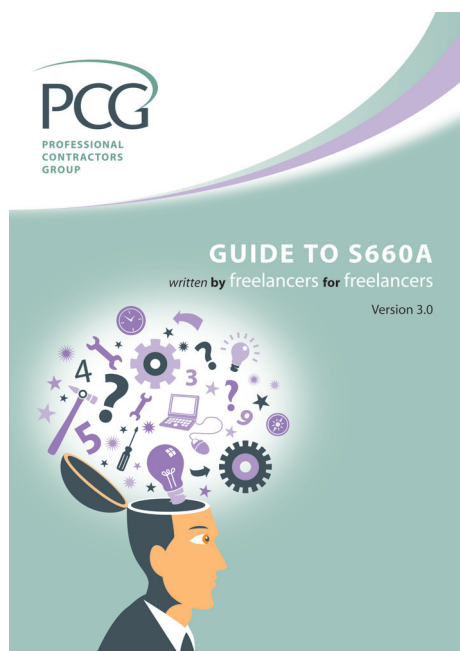
What is S660A?

Section S660A or S660A is part of the so-called “settlements legislation”, which was first introduced in the 1930s. Its aim is to prevent someone characterising their own income as someone else’s in order to pay less tax on it.

HMRC is seeking to apply S660A to freelancers when:

- There is a limited company (or partnership)
- Ownership is shared with someone else (e.g. a spouse)
- The freelancer is the sole or main fee-earner
- The other owner receives dividend or profit share

Many freelance businesses, under advice from their accountants, operate precisely this structure. Typically, when assessing liability, the Revenue seeks to go back six years, which can result in a tax assessment of over £40,000.



PCG position

PCG’s position is that HMRC is wholly wrong, both morally and in law, to attack family businesses through the settlements legislation and especially where retrospective tax is sought.

It is the clear view of virtually every taxation professional to have written or commented about this issue that HMRC has changed its stance on this matter, despite its protestations to the contrary. It is entirely unjustified to seek to apply this interpretation to arrangements in tax years prior to the release of Tax Bulletin 64 (April 2003), when key details of HMRC’s stance were simply not available to those taking decisions on corporate structures.

PCG is also concerned about how difficult it is to calculate a tax liability accurately under self-assessment regimes where detailed guidance is not available, and where tenuously defined concepts such as “commercial salary” are referenced. A self-assessment regime requires consistency, clarity and common sense. HMRC’s stance on S660A is devoid of any of these qualities.

PCG protection against S660A

PCG has teamed up with leading tax professionals Accountax Consulting to develop SARA - an online diagnostic tool which enables freelancers reliably to assess their risk of challenge under S660A. SARA is available to members at a heavily discounted rate of £25.

PCG’s Guide to S660A, available to members only, includes full background information, details of the current legal position of S660A, tips on how to minimise your exposure and details of how to calculate the amount of tax that would be due if S660A applied.

The Professional Expenses Insurance that comes as standard with PCG membership covers the professional fees of leading experts throughout any S660A investigation. Membership also gives you access to free tax and legal helplines, standard contract templates and discounted professional indemnity insurance.



Geoff and Diana Jones with PCG chairman Simon Juden at the Royal Courts of Justice

The Arctic case

The first S660A case to go through the courts is that of Arctic Systems Ltd, a West Sussex based consulting business owned and run by Geoff and Diana Jones.

The case has so far been heard at the Special Commissioners and at the High Court. PCG is supporting the case as it goes to the Court of Appeal later in 2005.

For further information

www.pcg.org.uk



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Professional Contractors Group Limited
Sovereign Court, 635 Sipson Road, West Drayton UB7 0JE
t: 0845 125 9899 f: 0845 644 4105 e: admin@pcg.org.uk