PROFESSIONAL CONTRACTORS GROUP

BUDGET BRIEFING

PCG
PROFESSIONAL CONTRACTORS GROUP

BUDGET 2004

For freelancers doing well, this year's Budget brought reasonably good news. Corporation tax rates, and a whole raft of other rates, are being frozen, and historically this has been good for stability. The widely feared "IR591" has either been postponed to next year, pending a review of the distinction between employed and self-employed status, or dissipated entirely for those with profits over £50,000. There will be no new National Insurance on dividends in the new personal tax year.

For those with profits under £50,000, however, things are less rosy. Profits paid out as dividends must now have had at least 19% corporation tax paid on them before they leave the company. Someone who recently incorporated his sole trader business or partnership, to take advantage of the previous encouragements the Chancellor offered - most notably the zero starting rate of corporation tax - has now apparently had the trap sprung and the incentive removed. Disincorporation is, not surprisingly, much harder and more costly than incorporation.

Simon Griffiths, PCG chairman, said, "While we have concerns about the new measure, the fact that the Chancellor has shied away from the more extreme suggestions put in front of him pays testament to the efficacy of the PCG's ongoing contacts with the Government. It provides further demonstration of the way that PCG has matured and developed, especially in the last two years. Clearly, this measure will have the greatest impact on those freelancers whose businesses are struggling or in their infancy, but many of our members will not be affected at all."

Of course the bad news for all freelancers is that the uncertainty and unfairness inherent in IR35 and S660A, with their concomitant paperwork mountain, remains. The Chancellor did not avail himself of the chance to abolish or reform either measure, and that must be viewed as a golden opportunity missed in terms of tangible help for freelancers.

The UK model of highly skilled, highly mobile and highly flexible freelancers is unparalleled in the developed world and PCG believes that the Chancellor should be encouraging and nurturing this critical sector of our economy. Indeed, many sectors now show an increased demand for freelancers, driven by a desire for the quality and innovation that freelancers can inject.

Dave Smith FTII, managing director of Accountax Consulting Limited, whilst welcoming the Chancellor's professed commitment to investment in small business, expressed dismay at what was not in the Budget. "The Chancellor has done nothing to ease the burden on small business," he said. "The confusion surrounding IR35 and S660A is untouched by this Budget. All he has done is to introduce another layer of tax, on those companies making small profits; the fledgling businesses struggling on the margins of profitability. These are the very businesses encouraged to incorporate by measures originally introduced by him."

19% corporation tax on dividends: how can I avoid it?

The maximum exposure to the new corporation tax on dividends is £1,900 in a tax year, for those with a profit of £10,000 who withdraw the lot as a dividend. The obvious way to avoid it this year is to pay a dividend before 1 April 2004. An alternative from that date forward might be to consider paying the money into a pension scheme instead; the new rules on pensions make this easier. Professional advice should be sought before taking action.

Employed or not employed, that is the question

The issue of deciding whether someone is employed or not is one of the most critical – and criticised – parts of IR35. In his Budget, Gordon Brown commented on the difficulty in "[matching] definitions for tax purposes with underlying economic characteristics" – words that will ring very true indeed for many freelancers. He cited "the growth in small owner-managed businesses, as well as the changing nature of employment and contractual relationships" as "creating challenges for the definitions and boundaries in the tax and national insurance systems between income from self-employment and the remuneration of owner-managers." He went on to state that, "The Government therefore proposes to consider the strategic issues raised by these developments, to ensure that the tax system reflects the realities of today's changing labour market and business environment. A discussion paper will be issued at the time of the 2004 Pre-Budget Report".

Simon Griffiths said, "It goes without saying that PCG will participate fully in the consultation process, and we welcome the opportunity to re-examine the application of 19th-century law to 21st-century modes of working. Further, we would renew our call for a wholesale review of the difference between earned and non-earned income."

PCG legal director Dr Simon Juden commented, "It is possible that the 19% corporation tax rule is an introductory measure and the outcome of this review will be the 'real' implementation of 'IR591'. We know that the Chancellor had some rather scary options on a piece of paper and the fact that he has had the courage to listen to what we have said and reject them, pending proper consultation, does him great credit."

IR35 and S660A: help at hand

At times, it seems that freelancers have been made subject to some strange physical law, whereby it is impossible to know both your precise market rate and your precise tax bill at the same instant. One thing this Budget certainly does not do is reduce the uncertainty inherent in taxes affecting freelancers, with neither IR35 nor S660A having been touched by the Chancellor.

Two new services offered by PCG can help.

Firstly, many who initially thought they were caught by IR35 are now no longer sure, thanks perhaps to increased understanding of the measure, and the fact that PCG and its affiliates have saved members over £6 million in unnecessary tax and legal expenses to date. PCG and Accountax Consulting Ltd recently launched IR35 Payback, a no win, no fee scheme through which IR35 tax and National Insurance contributions paid in error can be reclaimed from the Inland Revenue. Details may be found at *www.pcg.org.uk/resources/IR35Payback.html*

Secondly, those concerned that they may be subject to an investigation on S660A may use the online SARA tool to evaluate their exposure. This is a highly sophisticated tool, again developed in partnership with Accountax Consulting Ltd, which asks some 35 detailed questions before giving an accurate evaluation of the risk (taking the Inland Revenue's view of the law) of an attack under S660A. The tool may be found online at *www.pcg.org.uk/sara*

Clever schemes for tax avoidance

Gordon Brown announced that "new measures are being introduced with immediate effect to close down…avoidance schemes [which] usually operate through artificial manipulation of profit shares between UK and offshore partners." He also announced that accountants would need to register any "avoidance schemes" for paying less tax with the Revenue before they commenced operations. Coupled with the recent disclosure of a new IR Compliance Unit dedicated to monitoring such schemes, this could spell the end of many of the less reputable umbrella companies, "avoidance" regimes using Employee Benefit Trusts and the like.

Dr Juden said, "PCG advice has always been to steer well clear of any scheme which seems too good to be true – it probably is. It comes as no surprise that the Revenue is taking a close interest: indeed it is quite right that it should. Any freelancers who have involved themselves in such schemes should avail themselves of our legal and tax helplines - free to PCG members – as a matter of urgency."

Do the REIT thing

The Chancellor announced that Real Estate Investment Trusts (REITs) will be launched following consultation. Historically, it has been shown that as stock markets go up, housing goes down and vice versa, so these trusts offer a hedging opportunity for those freelancers with money to invest.

Pensions

The rules on pension contributions are to change radically from 6 April 2006. There will be no link between allowable contributions and earnings; however, a lifetime fund limit of £1.5 million (which will increase with time) will be set. There will be a maximum annual contribution, initially set at £215,000.

Further, restrictions on what pension schemes can invest in have been relaxed and forthwith pension schemes may invest in residential property. The maximum lump sum that can be withdrawn on retirement will remain 25%.

Dr Juden said, "At the time of writing, details are only just emerging. This does, however, appear to offer many tax planning opportunities. Those who are IR35 caught may be able to pay as much of their turnover as they like (up to £215,000, an upper limit few freelancers will reach) into a pension fund before applying the deemed salary calculation. Furthermore, certain styles of pension such as SIPPs allow those running the scheme – something that freelancers can in certain circumstances do themselves – to decide how the money should be invested. PCG will analyse this measure fully and publish comprehensive guidance on our website at www.pcg.org.uk".

VAT

The VAT threshold has been increased to £58,000 – a level rightly described by the Chancellor as "the most generous in Europe". Furthermore, 13,000 businesses will benefit from simplified VAT accounting. PCG director Keith Hogben said, "Flat-rate and other simplified schemes reduce the red tape burden under which our members operate and are to be welcomed, in principle."

A marriage of inconvenience?

The Chancellor announced that the Inland Revenue and HM Customs and Excise were to be merged. PCG welcomes the reduction in the number of official bodies with which businesses must interface, and hopes for a concomitant reduction in red tape and bureaucracy. Care is, however, needed in terms of extending the wide powers - rightly accorded to HM Customs and Excise to investigate the worst kinds of criminal activity - to every tax inspector in the land.

Another consideration is that the Inland Revenue is already overstretched, with response times to queries often vastly exceeding published targets. PCG director Richard Robson said, "With a reduction in staff of 40,000 and the overhead of the merger to come, we are concerned about the maintenance of service levels. Following the merger of Revenue with Benefits Agency, many low-grade staff were assigned to tasks previously – and more properly - handled by highly trained and competent inspectors. We call on those managing the merger to pay particular attention to the levels of service that taxpayers receive during the transition as well as after it."

Capital allowances

The first year capital allowance of 100% for IT equipment will disappear after 31 March 2004, to be replaced by a 50% first year allowance for most capital expenditure in the next twelve months. The most obvious exception to this is the purchase of cars, which do not qualify. This means that freelancers and others may no longer write off the whole capital cost of IT purchases such as computers, printers and internet-enabled phones against tax in the year those purchases are made.

S660A loophole closed

Some commentators have suggested a workaround to S660A involving shares owned jointly with the dividend split elected so as to minimise the overall tax bill. This Budget removes this loophole, known as S282A. The fact that the Chancellor has done this shows that he has confidence that the Revenue's application of S660A is legally correct, despite the contrary opinion of virtually the entire tax profession.

Tax insurance: still a business necessity

The need for strong, effective insurance to cover professional expenses if investigated for tax, VAT, IR35 or S660A was if anything emphasised by the Budget. Insurance expert Paul Mason, of Abbey Tax Protection Ltd, cited an "increased need for representation and so for contractors to be insured" by products such as the Professional Expenses Insurance provided to all PCG members at no extra charge and PCG's optional Route35 product.

Company car rates and company vans

The Chancellor has pre-announced company car rates for the next three years, and increased the taxable benefit in kind on company vans from £500 to £3,000 by 2007, with an additional £500 if private fuel is provided. Dr Juden said, "We welcome the certainty that the Chancellor has provided by announcing the car rates for the next three years. This will allow those freelancers who use company vehicles to plan forward expenditure more accurately. We would like this principle to be extended to other areas in order to facilitate forward planning."

Acknowledgments

PCG selected a team of specialists, including representatives from Accountax, to provide expert tax and political analysis on Budget day and formulate a definitive view of the announcements from a freelance small business owner's perspective. Key members of the team included:

PCG legal director Dr Simon Juden

Dave Smith and Jason Piper from Accountax Consulting Limited

PCG senior political adviser David Ramsden

PCG director Richard Robson orchestrated the Budget day plan and activities, and the team was supported throughout the process by marketing strategy adviser Diana Watson of Bespoke Marketing and Consulting, and administration manager Kevin Stearns.

DISCLAIMER
The information provided in this document does not constitute financial, investment or tax advice. It is intended to provide general information and viewpoints only and does not attempt to give you advice that relates to your specific circumstances. You are advised to discuss your specific requirements with an independent financial adviser prior to entering into any binding contracts.

Whilst PCG has taken reasonable care to ensure that the information in this document is accurate and up to date, neither PCG nor its suppliers warrant that it is. Neither PCG nor its suppliers have any control over the accuracy or completeness of third party data and all liability in respect of the same is expressly excluded to the maximum extent permitted by law.

Benefits of membership

Freelance contractors may join PCG as full members, for an annual fee of just £120 plus VAT for a single fee earner, which buys:

- Professional Expenses Insurance (PEI) covers the professional fees of experts throughout:
  - VAT disputes
  - Full enquiries on Self Assessments for Incorporated or Corporate Tax
  - Aspect enquiries for Corporation Tax
  - PAYE compliance disputes (including P11D problems)
  - NIC disputes
  - S660A cases
  - IR35 cases
- Access to free tax and legal help lines
- IR35 S660A and IR591 analysis and manuals
- Standard contract templates
- Discounted professional indemnity insurance
- Access to a wealth of technical and commercial advice via the forums
- A comprehensive range of member services and preferential rates from suppliers, including home office insurance, hotels and travel, business software, training and office space.

The range of PCG membership benefits is comprehensive. Taken alone, the basket of insurances, help lines, draft contracts and other items that are bundled in your membership fee might cost you as an individual over £970.

PCG membership is not just about benefits though. Any freelancer who wants to be represented in the economic and political decision-making processes and to make a stand for the value of freelancing should join PCG.

According to Jon Leach, the Head of Integration at Chime Communications plc, "Freelancers are educated, teched-up, and confident in their ability to sell their services and to move flexibly from project to project." There is a growing trend towards freelancing and flexible working, and the freelance small business community should have the voice and the credibility that it deserves.

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 and providing industry with a flexible workforce. PCG is the only not-for-profit organisation in the UK run by freelancers for freelancers, and is committed to promoting members commercially and supporting their development.

For further information, contact:

Professional Contractors Group Limited
Lakeside House
1 Furzeground Way
Stockley Park East
Uxbridge
UB11 1BD

Telephone: 0845 125 9899
Facsimile: 020 8622 3200
Website: www.pcg.org.uk