

Response by the Professional Contractors Group to the consultation paper “Small companies, the self-employed and the tax system”

Introduction

The Professional Contractors Group (PCG) welcomes the consultation paper “Small companies, the self-employed and the tax system” as a useful statement of principle which would benefit those we represent. Our detailed response follows.

A welcome statement of common sense

We welcome the acknowledgment of changing employment relationships and contractual flexibility in the UK (1.1), the rise of the knowledge-driven economy (1.4) and the dynamic and innovative role of small businesses. We agree with the statement that businesses should have the flexibility available to them to adopt the structure that suits them best (1.9). We also agree that business structures should be determined by business considerations, not consideration of tax benefits (1.9 and 3.26). The tax tail should certainly not wag the business dog.

Reconciling theory and practice

The PCG would like to see the extremely sensible approach of this paper extended across government policy. This would create a consistency and clarity of policy which currently does not exist. For instance, the statement that, “the Government actively encourages diverse forms of employment, including self-employment,” (2.17) could be a useful starting-point for reform of the notorious “IR35” legislation, which PCG believes actively discourages simple forms of self-employment by denying that entirely legitimate companies are actually in business on their own account at all. Such reform would also encourage reinvestment and training which the paper recognises as vital to maintaining skills that are so important to the UK's economy. In some instances IR35 has forced businesses to close down, which is surely contrary to the Government's stated aim of increasing employment opportunities (2.1). Legislative reform will be necessary to reverse this policy in line with the principles set out in the paper and to achieve IR35's stated aim of combating tax avoidance without harming genuine businesses.

The approach outlined in the report will also, if followed in practice, allow for the reversal of the current interpretation by HMRC of the settlements legislation. We welcome the report's acknowledgment (3.10) that in a business partnership, “the partners share the risks, costs and responsibilities of being in business [and] are entitled to a share of the profits and gains of the business.” Yet when husband-wife partnerships are incorporated, the Revenue seeks to deny each partner the share of the profits and gains to which they are rightfully entitled. The policy also runs contrary to the report's entirely correct assertion of the principle (4.8) that, “the tax treatment of dividends... reflects the assumption that the dividends are a return on the shareholder's investment in the company (as distinct from earnings which are a reward for labour),” by treating one partner's dividends as the other's earnings. It would be straightforward for HMRC to revert to the earlier interpretation of the legislation which did not treat dividends from a company to a spouse as bounty.

We are pleased to see the paper's observations (2.5) on the value of small enterprises' ability to, “present a strong competitive challenge to incumbent firms [and] provide a stimulus to productivity growth.” However, the Government's own procurement procedures do not currently act on this and set extremely arduous challenges for smaller businesses, with the result that virtually all procurement contracts are with larger companies. We have made representation to the OGC as part of a recent consultation on this issue which, in short, calls upon Government to consider facilitating easier access to government procurement contracts for independent contractors, whose expertise will often be of benefit to a given project.

The PCG agrees fully with the report's suggestion that business structures should be determined by business rather than tax considerations and understands the Government's concern that self-employed individuals are adopting corporate structures for tax reasons (3.26). The zero starting rate of corporation tax introduced and then rapidly removed by the Chancellor in his more recent Budgets has, unfortunately, contributed somewhat to this. In this instance we would welcome a period of stability in corporation tax and view the current arrangements as adequate for discouraging incorporation for tax purposes, albeit not ideal for our members.

Overall, had the common-sense principles espoused in this paper been applied consistently over the last few years, many policies which have been detrimental both to thousands of independent freelancers and the economy as a whole would not have been implemented. The clarity with which the paper enunciates sensible principles for the taxation of small businesses represents a substantial opportunity to reconcile theory and practice in these areas.

Responses to specific questions

Of the questions posed at the end of the paper (5.4), by far the most important is the final one: “whether and to what extent businesses would value the benefits of certainty and simplicity over specific incentive structures.” Without doubt those whom we represent would prefer simplicity over incentives. Self-employed contractors operate one of the simplest business models possible, yet at present the tax regime pertaining to them is of such Byzantine complexity as to make self-assessment almost impossible. Once a clearer and simpler structure is in place it may be appropriate to offer new incentive structures, but it is our experience that small business owners are highly motivated people capable of driving for greater innovation and productivity. New incentives should therefore not be a priority and, if bolted on to a tax system that already represents a Gordian knot for many, could well be ineffective or even counter-productive.

The segmenting of owner-managers of companies from other company owners for tax purposes could well be a useful measure if implemented well, and the PCG will be happy to discuss this further. A related reform we would like to be considered is the introduction of a statutory right to be self-employed, also suggested by the Federation of Small Businesses. This would allow an individual to be taxed as self-employed and, as a trade-off, abdicate all rights as an employee such as National Insurance contributions for the period in question. This would also have the effect of neutralising IR35, which could be left to deal with the problem it was intended to solve, while genuine contractors would be placed outside it.