



Patron: the Rt Hon the Lord Weatherill DL

17th September, 1999

The Rt Hon Tony Blair MP Prime Minister
10 Downing Street
London
SW1A 2AA

Dear Prime Minister

Service companies, the economy and taxation: URGENT

I write as the Chairman of the Professional Contractors Group (the "PCG"). We represent the interests of consultant contractors working in the knowledge-based industries - largely IT and engineering. The PCG was founded as a web-based discussion forum last March, when over 3000 contractors like myself recognised the dangers inherent in the Chancellor's budget proposals contained in Press release No IR 35.

As the Financial Times reported on 28th July the PCG is a living, breathing example of the power of knowledge-based technology and the internet - the very forces which you have recognised as being key to this country's economic future. In the space of a few weeks we raised over £150,000 to fund a campaign to try to ensure that the final proposals are proportionate to the problems and are based on proper and full consultation with all relevant parties in accordance with the better regulation guidelines you have endorsed.

I am writing to you for two reasons.

Firstly, we are very concerned that the Treasury ministers responsible for these proposals are in breach of the better regulation guidelines in a number of ways. They have refused to enter into a proper consultation process. Instead, they have held only one formal meeting, in June, not to consult on the principles, but merely to get feedback on their proposals for the practical mechanics of implementation. There were press reports last week that Dawn Primarolo held a secret meeting recently at which the latest version of the proposals were outlined. However the PCG were not invited, despite the fact that we are the only body which can legitimately claim to represent the knowledge-based contractors. We understand the Federation of Small Businesses were also excluded from this meeting.

In addition, despite it being a requirement of the guidelines the Treasury have failed to carry out a full regulatory impact assessment. To date all that has been produced is in connection within the Welfare Reform and Pensions Bill, which included last minute additions to give effect to the National Insurance aspects of IR 35. Hence this RIA only covers the National Insurance elements of IR 35 and not the PAYE

aspects, which are an inseparable part of the proposals. How can Government make a fully informed judgement on the proposals without having considered all aspects of the issue?

It is also apparent from the RIA that the Treasury does not seem to have a firm basis for making any assessment of the impact of their proposals. The RIA refers to there being between 50,000 and 66,000 companies offering personal services. However, as was reported by the Financial Times on 15th September (page 10 "Start ups at highest for seven years"), 20% of the 122,000 new businesses started in the second quarter of 1999 alone are service businesses. Almost by definition most of these will, in their early days, be selling the personal services of their owners and hence are likely to be caught by the IR 35 proposals. This suggests that the Treasury have not properly identified the full extent, or economic significance, of the sector they are planning to attack.

If, as we suspect, IR 35 results in many fledgling entrepreneurs being taxed as if they were employees of their clients, with almost all income being taxed and no ability to retain profits for future development, the impact on your dream of business and wealth creation will be immeasurable.

The PCG is also very concerned that the Treasury totally fails to understand the entrepreneurial spirit which underlies the knowledge-based contracting sector. The members of the PCG represent some of the cream of the country's engineers and IT specialists. They sell their skills and knowledge in the open market. Both you and Stephen Byers at the DTI seem to grasp the fact that our economic future lies with our ability to cultivate and deploy these highly skilled knowledge-based workers. We find it inconsistent with your vision of a knowledge driven economy that the rules the Treasury wish to utilise for IR 35 will consider a business that invests in an asset such as a van a "genuine business" yet will consider a business that invests in knowledge a "disguised employee".

Rather than expound at length on this issue I am attaching the text of comments which one of our members posted on our discussion forum recently. The situation outlined is typical of the knowledge-based sector.

IR 35 threatens to undermine your dream of an economy driven forward by the knowledge-based sector and new entrepreneurial businesses. It is appalling that Treasury Ministers are refusing to follow due process and undertake proper consultations. It is frightening that they may destroy our position as the most flexible and, hence, effective deployers of knowledge-based skills in Europe without having even tried to gain a proper understanding of the animal they are dealing with. One can only begin to wonder at their motives for putting at risk so much of the economic credibility which you and New Labour have fought to achieve over the last two years.

One thing we can be sure of. If the proposals go ahead as presently drafted the main beneficiaries will be international IT companies like EDS, who will see annoying competition driven out of the market place, and who, coincidentally, will be able to charge more fees to the Inland Revenue for adapting the Revenue's IT systems to take account of the changes. Is this really what New Labour wants?

In a survey of over 4000 knowledge-based contractors conducted on our web site this spring the majority indicated that they voted for New Labour in the last election. These PCG members are powerful supporters of your vision of an economic future driven by knowledge-based enterprise. We are increasingly concerned that our

common dream will be throttled by the Treasury's ill conceived plans to raise £475 million (their figures) by putting asunder the veil of incorporation which has been accepted for generations. In doing so they will be forcing thousands of people who **do** consider themselves to be operating genuine businesses to close their companies.

We are fully supportive of the objectives contained within IR 35. We believe in fairness in taxation and also that no person should be forced into starting their own Company, thus putting at risk protection they may receive from employment rights. We have suggested that self regulation would be an approach to be considered. Please help us by insisting that your Ministers follow the guidelines you have endorsed and issue clear proposals, supported by a full RIA and subject to proper consultation with all relevant interested parties.

Yours sincerely

A.F.White
Chairman, Professional Contractors Group

Enclosure: text of comments received from a member of the PCG through our web site

Comments received on the PCG web site 13 September 1999

Four years ago I was a consultant working for a major American consultancy - one of the four biggest. In my final year I was billed out to clients for 48 weeks of the year at over £700 per day, making a total of over £150,000. I was paid a salary of £25,000. I usually worked about 60hrs per week. I travelled all over the country. I received little training. This didn't seem equitable to me.

So, I set up my own one-man company. I charged out at a much reduced rate - £240 per day. The work I did in my company was exactly the same as I previously did for the consultancy. The relationship between the client and myself was the same. I even kept my salary at the same level.

There were some differences I could make now that I was in control. I invested in hardware, training, documentation and software. I was certain that the internet was the future, and so I spent a huge amount of my time training myself in networks, the internet and the web. I took on some small additional jobs maintaining web sites to extend my experience. Latterly, I have trained in Linux, C and perl. As a result I now advise my most recent clients with their intranet strategies.

As I kept my salary the same when I set up my own company I can be certain that I have not paid reduced NI. I am also sure that the tax I pay is way in excess of my previous tax. I paid over £18,000 tax last year (Income Tax, ACT, Corporation Tax and NI).

However, the Inland Revenue, in its new IR35 changes considers me to be a 'disguised employee', and that I am 'avoiding tax'. Apparently, if I go back to work for the American consultancy, do the same work and have the same relationship with the client I'm OK again - no disguised employment.

Even if I try to stay in contract work I'll be limited in what I can spend. Any expenses above 5% of gross revenue will be taxed as if it was salary, and travel will eat up this 5% very quickly. The American consultancy - well they get all their expenses tax free !

Together with some other contractors I was about to set up a new company to make bids for substantial fixed-price contracts. The initial capital funding and underwriting of the new venture was to come from the profits of our current companies. This is now on hold.

The IR35 changes are plainly wrong. They suppress competition from small companies to large companies. They will reduce start-up companies. They penalise innovation. They limit employment mobility. All of this in the very knowledge-based industries that could be the life-blood of UK PLC.

Remember, true ground-breaking innovation does not come from established big companies. Apple, Microsoft, Netscape were tiny start-ups.

We must keep up this fight - for our own sakes, and I believe for the UK.