PCG Client Briefing

News on the latest proposal on the new tax rules, known as IR35.

On the 24th of September, the Inland Revenue issued a press release detailing changes made to the proposals, which they say are the result of consultation with the industry.

The rules will enable Contractors to continue trading through their Limited Companies, although under an entirely different tax regime. From the Contractors perspective the rules are illogical and oppressive and the PCG will continue to fight for further changes. The appendix to this document is a real life case study of a PCG member that shows just how illogical and unfair the new proposal remains from the Contractor perspective.

What the Changes Mean to Contractors Clients.

The revised rules actually appear to be a significant improvement from the Client perspective in many ways. The Inland Revenue have made the burden of proof rest on the Contractor for demonstrating that they are not “disguised employees” of the Client. In the past the uncertainty over the arrangement between Contractor and Client, has meant that many Companies have chosen to use Agencies, in order to reduce the risk of having to bear the Contractors tax responsibilities following a Revenue inspection. The new rules therefore open up the possibility of Contractors working direct with the Client with no intervening Agency. Agencies will still be able to supply contract staff to those companies that prefer this arrangement, but there is no longer any risk to Client companies in using a different route.

Of course there is no such thing as a free lunch. Contractors costs in the UK are likely to increase greatly as a result of the new proposal. This will result from a combination of the increased compliance costs they face as a result of these complex rules and the movement of Contractors out of the UK to Countries with a more “enterprise friendly” culture. This is bound to mean that the costs of employing Contractors will increase, but it is still likely to be far less expensive to hire a skilled Independent Contractor than to hire from the larger Consultancies and Software Houses. The PCG would argue that not only will the cost be lower, but the level of expertise available will be higher.

The PCG.

The PCG was formed 5 months ago. It is a not-for-profit organisation run by a company limited by guarantee. It was formed in response to the governments “IR35” proposals in order to provide a voice for Contractors. The PCG now has a membership in excess of three and a half thousand, and is growing all the time. Recently the PCG membership voted to turn this organisation into a permanent body, to represent Independent Contractor’s interests to both the government and the industry in general.

The New Proposals.

In brief the new proposals are as follows:-

1) Contractors Limited Company responsible for application of the rules.
2) The existing “self-employment” tests to be used to uncover “disguised employment”.
3) If caught by the new rules the contractor will be allowed schedule E expenses (Travel etc).
4) 5% of gross turnover to be allowed for company expenses.
5) The remainder of contractors turnover will be deemed to have been paid as salary by the Revenue.
6) It appears at present that no allowance is to be made for contractors to pay for training and equipment over and above the 5%.

Further Information.

Inland Revenue Press Release – http://www.inlandrevenue.gov.uk/ir35/seprelease.htm

Inland Revenue Notes on the rules - http://www.inlandrevenue.gov.uk/ir35/summary.htm

PCG Website public area – http://www.pcgroup.org.uk

What you can do

Join the PCG as an Associate member. This will allow you access to the confidential information commissioned by the PCG relating to these proposals including advice from top Accountants and Lawyers. In addition you will receive an email newsletter keeping you up to date with the latest developments. You can join at http://www.pcgroup.org.uk

APPENDIX : CASE STUDY - PCG MEMBER

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 traveled 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.