

Budget promises contractors IR35 review, but high-earning contractors face tax hikes

Contractors following the Emergency Budget will be pleased with the promised review of IR35 as part of a wider review of small business taxation. But other news in the budget is less welcome. Whilst those on lower and middle incomes will benefit from an increase in the tax-free personal allowance, higher earners will pay more, and everyone will be hit by an increase in VAT to 20% from next year.

Chancellor George Osborne's key budget measures impacting contractors include:

- o IR35 review promised as part of a wider review of small business taxation with details to be revealed 'shortly'
- o VAT increases by 2.5% from 17.5% to 20%, starting from 4 January 2011
- o The basic personal tax free allowance increases by £1,000 to £7,475 from April 2011
- o Capital Gains Tax increases from 18% to 28% for higher rate taxpayers from midnight tonight
- o The main rate of corporation tax for most large contractor clients will fall 1% per year from 2011 until it reaches 24%
- o Small business corporation tax will be reduced to 20% in 2011
- o Higher rate income tax bands will be frozen until 2013-2014
- o The landline levy to pay for high-speed internet will be abolished before it comes into force
- o Fuel duty remains the same
- o No mention of income shifting or umbrella expenses.

Public sector contractor clients

There was some good news for contractors dependant on the public sector because, although the Chancellor pledged to reduce public sector borrowing by "77% through spending reductions and 23% through tax increases", there are no plans to make additional steeper cuts in capital spending.

However, the Chancellor said that projects must make a "Significant economic return for the country". In real terms, departments outside of the NHS and international development obligations to the poorest countries will see spending fall by 25% over the next four years.

Coupled with a two-year pay freeze for public sector workers earning over £21,000 –forcing many such workers to reconsider their future as state workers – contractors may find that the savage cuts to public spending may actually increase public sector opportunities. Other contractors will be pleased with the announcement that many major capital projects in transport and infrastructure will proceed.

UK is "open for business"

The Chancellor announced that a five-year programme of reform of the corporation tax system is planned, because, "... the business community want certainty from government, lower rates, simpler rules, and a stable and consistent platform for private sector recovery."

Measures to help business include the reduction of the main corporation tax rate of 1% per year over four years until the rate reaches 24%. Small business corporation tax will fall to 20% in 2011.

Most contractor limited companies won't be affected by the tinkering with capital allowances, which include a small reduction in rates from 20% to 18% per year for short term assets, and longer term assets falling 10% - 8% to come into force in 2012. Similarly, changes to National Insurance Contributions won't affect limited company contractors or umbrella company contractors.

VAT increases and duties frozen

The big news, although widely predicted, was the increase in VAT from 17.5% to 20% coming into force on 4 January 2011. Although VAT-registered contractors won't feel the impact of the rate rise impact on their business costs, consumer goods will become more expensive and that could potentially have a negative impact on the economy as a whole.

Those categories already VAT exempt such, as food, books and children's clothes, will remain so. However, most contractors are likely to be hit by the cost of business and domestic insurance VAT rates rising from 5% to 6%.

The large VAT hike will impact on the bottom line of private sector businesses in some parts of the financial services sector, hitting

contractors serving them. Some public and third sector organisations unable to reclaim VAT will be further squeezed by the VAT rise, and this is likely to hit VAT-registered contractors serving them.

Personal allowances, CGT and pensions

Workers with earnings under the higher rate threshold will enjoy an additional £1,000 of tax-free personal allowance from April 2011. For limited company contractors sharing the business with a spouse, this means £2,000 per year that can be earned with no tax. However, higher and top rate taxpayers won't benefit from the rate increase.

Higher earning contractors will also be hit by an increase in capital gains tax (CGT), with those in the higher rate band paying 28% on the sale of assets. Lower-earning contractors will continue to pay 18%, while entrepreneurs' relief for contractors who build a bigger business can benefit from the 10% Entrepreneurs Relief rate on £5m.

“ ... the business community want certainty from government, lower rates, simpler rules, and a stable and consistent platform for private sector recovery ”

George Osborne, Chancellor

There could be some light at the end of the pensions tunnel for top-earning contractors, as the Chancellor announced that the Treasury would work with the pensions industry to find a solution that reduced complexity but protected the £3.5bn that has been raised by the Treasury from top tax rate payers as a result of the loss of tax relief on pension payments.

Office of Tax Simplification and IR35 review promised

In two places in its budget document, the Government repeated its pledge to review IR35 as part of wider measures to simplify small business taxation. Details are to be released 'shortly', said Osborne. The promised Office of Tax Simplification will be created and, here too, further details are promised in the near future.

The budget document also reveals that the government is considering a General Anti-Avoidance Rule to tackle systemic tax avoidance. ContractorCalculator will be following this closely, and will report on any changes that could affect some contractors.

Osborne said of his budget: "We have been tough, but we have also been fair." And many observers feel the compromises struck by both Conservatives and Liberal Democrats in the coalition government have indeed provided an emergency budget in which everyone 'shares the pain'.

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