

Contractor-friendly emergency budget could have a nasty tax-sting in its tail

Contractors across the board will benefit from many of the measures introduced in the coalition government's first budget, which includes a raft of proposals designed to stimulate enterprise and support businesses. There is also a restated commitment to review [IR35](#) and small business taxation. But news on pensions and capital gains tax is less welcome.

"George Osborne delivered an intelligent and decisive budget, which has tried to tackle the historical deficit this country faces," says John Brazier, [PCG](#) managing director. "[Osborne] stated he wanted to create certainty and stability and we believe that many of his measures will do this. The roadmap for corporation tax and the laying out of income tax changes over the course of the Parliament are welcome and will help PCG members in their businesses."

Other commentators have welcomed the budget, too. Anne Redston, Visiting Professor of Taxation at King's College London, told PCG: "This budget has left freelancers and contractors relatively unscathed on the tax front. The promise of a small business review has been firmed up, and the Office of Tax Simplification is long overdue."

Not all positive for contractors

Some budget measures have prompted concern. For example, there is a commitment to review pension rules, which could result in reduced tax-free contribution allowances and higher tax bills for contractors.

In addition, the increase in capital gains tax, which came into effect from midnight on 22nd June 2010, means an immediate increase in tax liabilities for contractors disposing of qualifying assets who have incomes over the higher rate of tax.

Culture favours limited company contractors

But the positive news on tax outweighs the negative. Derek Kelly, managing director of contractor accountant [ClearSky Accounting](#), says the budget has made limited company contracting even more favourable as a tax-efficient option for contractors.

"The proposed reductions to corporation tax over the next four years mean that not only is it cheaper for contractors to operate via their own limited company, but their net income will also increase as a result," says Kelly. "This is improved further when you consider the increased rate of VAT to 20 per cent."

[Limited company contractors](#) have also been promised a review of IR35, as part of a wider review of all small business taxation and further details, including information on the proposed Office of Tax Simplification, are expected soon.

However, ContractorCalculator CEO Dave Chaplin warns contractors not to become complacent about IR35: "There are [IR35 investigations](#) still ongoing, and whilst HMRC is under-resourced and not able to mount the intensive enforcement campaigns of the early 'noughties', contractors should maintain their guard. Let's not forget that the UK's massive deficit means that all tax-raising avenues are likely to be explored."

Umbrella company contractors face triple-whammy... of benefits

Contractors working through [contractor umbrella companies](#) should benefit from three budget changes: tax breaks, National Insurance Contribution breaks and VAT relief, assuming their umbrella company passes on all the benefits.

According to Rob Crossland, chief executive of contractor umbrella solutions provider Parasol, NICs and increased personal allowances should be passed straight through to contractor pay packets: "The increase to the income tax threshold, coupled with the £21 per week increase in employers National Insurance Contributions, which we pass on to our contractors, will see them with more take-home pay in their pockets."

Crossland also urges contractors to offset an element of the VAT increases by ensuring that they claim all the business expenses they are legitimately entitled to.

Pensions risk to all contractors

“ This budget has left freelancers and contractors relatively unscathed on the tax front. The promise of a small business review has been firmed up, and the Office of Tax Simplification is long overdue ”

Anne Redstone, King's College London

“ The proposed reductions to corporation tax over the next four years mean that not only is it cheaper for contractors to operate via their own limited company, but their net income will also increase as a result ”

Derek Kelly, ClearSky

Independent Financial Advisers [ContractorFinancials](#) have [spotted an alarming clue](#) to possible draconian pension contribution taxation in the full budget document. Paragraph 1.118 on page 36 reveals that reduced allowances for all workers may be introduced.

The government plans to consult on "an alternative approach involving the reform of existing allowances, principally of a significantly reduced annual allowance". The [budget document](#) continues with: "Provisional analysis suggests that an annual allowance in the range of £30,000 to £45,000 would raise the necessary yield."

There is no further specific information about earnings thresholds of those that might be caught, but the result will almost certainly mean that a significant number of limited company contractors ploughing their income into private schemes and umbrella company contracts using salary sacrifice schemes could be caught by this net and end up paying more tax.

It is also possible, as ContractorFinancials highlights, that contractors with a history of regular contributions could continue to enjoy tax relief on a proportion of their past regular payments. So taking action on pensions now could reduce tax liabilities in the future.

Capital gains tax will have immediate impact

According to a [report by tax expert Rebecca Benneyworth published on AccountingWeb](#), the accountancy profession was not expecting the increase in capital gains tax (CGT) to be implemented immediately.

What this means is that many high-earning contractors with assets that attract CGT and who have, or are planning, to dispose of, some of these assets in this financial year may find their tax bills increase. At the same time, the calculations for tax planning have suddenly become much more complicated.

Although most measures affecting contractors introduced by the budget will not come into force until next year, contractors concerned that they may incur CGT liabilities should talk to their accountants urgently. Similarly, other changes, like that to be consulted on for pensions, mean that contractors would be wise to contact their independent financial advisers sooner rather than later.

Published: Wednesday, June 23, 2010

[Tweet](#)



Dave Chaplin
CEO
ContractorCalculator

Dave Chaplin is a former IT contractor in the City of London, and is founder and CEO of ContractorCalculator, and author of the Contractors' Handbook.

Started in 1999, ContractorCalculator (this site) is the leading independent website for the UK contracting industry – most of whom are highly skilled knowledge workers. [Read Full Profile...](#)

[View all our experts](#)

© 2011 All rights reserved. Reproduction in whole or in part without permission is prohibited. Please see our [copyright notice](#). If you want to use any content you have seen on this site then please [request our media pack](#) and ask for details of our Content Licencing Service.

Readers Comments...

 Be the first to comment on this article

Also of interest...

Related News:

- IR35 will be abolished, says Small Business Minister Mark Prisk
- Budget promises contractors IR35 review, but high-earning contractors face tax hikes

Related Guides:

- What triggers an HMRC IR35 investigation?

Related Calculators:

- IR35 Calculator

Related Internet Links:

- PCG
- Parasol
- ClearSky



ABCe verified website - last audit confirmed 130,682 monthly unique visitors

© Copyright 2011 Byte-Vision Limited UK. All rights reserved [Copyright notice](#)