ipse

Autumn Budget 2018

An analysis for IPSE by **Anne Redston** LLB, MA (Oxon), FCA, CTA (Fellow)

About IPSE

IPSE, the association for Independent Professionals and the Self-Employed, is the largest organisation in the EU, representing over 67,000 freelancers, contractors and consultants from every sector of the economy. It is a not-for-profit organisation owned and run by its members.

We believe that flexibility in the labour market is crucial to Britain's economic success, and the dedicate our work to improving the landscapre for the freelance way of working through our active and influential voice in government and industry.

IPSE aims to be the principle and definitive source of knowledge about freelancing and self-employment in the UK. We work with leading academic institutions and research agencies to provide empirical evidence about evolving market trends. This research supports our work with government and industry and delivers key market intelligence to help our members with business planning.

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1 INTRODUCTION

This briefing summarises the Budget tax announcements that are most likely to affect IPSE members. It discusses IR35, personal allowances and the higher rate threshold, as well as the VAT employment allowance and capital gains tax on homes. It also points to areas where expected changes did not occur.

The briefing doesn't explain everything in the Budget. In particular, it doesn't discuss the taxation of large businesses, most indirect taxes or welfare benefits. And it is only a summary: it is not a substitute for taking professional advice from a qualified accountant or tax adviser.

2 IR35

BACKGROUND AND BUDGET ANNOUNCEMENT

IR35 was introduced in the 1999 Finance Act, so is now nearly twenty years old. You need to consider IR35 if you work through a personal service company (PSC), but it isn't relevant if you work as a self-employed individual.

An engagement will be 'caught' by IR35 if:

There is a contract between your PSC and a client to supply your services; and

You would have been an employee of that client if the contract was with you instead of with the PSC.

The original IR35 legislation makes your PSC responsible for deciding whether IR35 applies. If your PSC decides an engagement is caught by IR35, it treats the money received from the client as your employment income, deducts PAYE and employee NICs, and pays that money over to HMRC – along with employer NICs.

For engagements with public authorities like NHS trusts and local councils, the law changed from 6 April 2017. The public authority, not the PSC, now has to decide whether IR35 applies.

The Budget announced that that these rules will be extended to private sector clients from April 2020.

This was the biggest money-spinner of all the Budget measures, estimated to bring in over £1bn in the first year alone. In other words, HMRC are expecting that lots of contractors will be reclassified as within IR35 as a result of this change.

THE CHANGES – SCOPE AND TIMING

The IR35 change will not apply to all private sector clients, but only to large and medium-sized businesses. The government has informed IPSE that they will use the definition from the Companies Act 2006. Broadly speaking, this is a company which meets two or more of the following conditions:

- Its turnover must be no more than £10.2m
- Its balance sheet assets must be no more than 5.1m
- It must have no more than 50 employees.

The rules will not come into force until April 6 2020. In the meantime there will be a detailed government consultation into how they will work, and IPSE will be involved in these discussions. That delay also gives you and your clients some time to think ahead.

WHAT HAPPENS IF YOUR CLIENT IS WITHIN THE NEW RULES

If your client is within the new rules, it must classify you as either inside or outside IR35. If your client classifies you as inside IR35, it must:

- Pay any VAT on your PSC's invoice in the same way as it does now
- Deduct PAYE and employee NICs on the VAT-exclusive amount, and
- Pay employer NICs on the same amount

You and your client will therefore both pay significantly more to HMRC than if you are outside IR35, when very low levels of NICs are usually payable.

Also, remember that if you are classified as inside IR35, you do not become an employee of your client. In other words, you have no employment rights against your client, even though you are paying the same tax and NICs as the client's employees.

If your client classifies you as outside IR35:

- Your position and your client's position remain the same as at present; but
- If HMRC later make enquiries, and decide that your status classification was incorrect, the client will have to pay PAYE and employee and employer NICs, plus interest – and possibly penalties – on the money paid to your PSC.

Most clients will therefore be nervous about classifying you as outside IR35, unless they are completely sure this is the position.

HOW DOES MY CLIENT KNOW WHETHER I AM INSIDE IR35?

HMRC encourage clients to use their 'Check Employment Status for Tax' (CEST) service to work out whether contractors are inside or outside IR35. This is an online questionnaire, designed to work through the many aspects of employment status.

If a client decides IR35 doesn't apply, and HMRC later disagree, they will not collect back tax and NICs if the client relied on a CEST outcome, as long as the client entered complete and honest information into CEST. That promise gives clients a big incentive to use CEST.

The client can also use an accountant, lawyer or other IR35 specialist to assess whether you are inside IR35 – or rely on its own knowledge of how the law works. But that doesn't carry the same guarantee as CEST, so if HMRC disagree with the classification, they will ask the client to pay the back tax and NICs.

WHAT CAN I DO?

It is sensible to assess your IR35 status now. Do this in a robust way. If you are economical with the truth, you are likely to have a nasty shock when your client carries out the same exercise.

You can use the CEST service to see what result your client would be likely to obtain. See www.gov.uk/guidance/check-employment-status-for-tax.

After you have assessed your IR35 status, consider whether there is anything you can do to improve your position. Can you change the way you work, so you have more control? Can you agree a job description with your client which makes clear how much autonomy you have? What factors in the CEST outcome were in your favour, and which were against you?

If there is a significant risk you will be classified as inside IR35, consider your negotiating position when it comes to renewing your contract, or starting a new one. Do you need to be paid more to compensate for the extra cost of being inside IR35? Can you build in some factors which make it more likely that you will be outside IR35?

You should also look out for changes to the contracts which clients (or intermediate agencies) ask the PSC to sign. Although under tax and NICs law, the obligation to pay IR35 tax and NICs no longer rests with the PSC, but with the client or agency, they may seek to rely on the contract to recover that money from the PSC (plus possibly interest and even penalties).

WILL HMRC CHASE ME FOR PREVIOUS YEARS?

HMRC can always collect back tax for four years. This extends to six years if you have been careless, and to twenty years if you acted deliberately (in other words, you knew IR35 applied but ignored it). For NICs the time limit is normally six years.

If you always believed you were outside IR35, but a client now classifies you as inside IR35, will HMRC check up on past years, when your PSC was responsible for deciding your IR35 status?

Budget documents promise that 'HMRC will focus its efforts on ensuring businesses comply with the reform, rather than focusing on historic cases' and being classified as within IR35 for the first time by your client 'will not automatically trigger an enquiry into earlier years'.

Despite that reassurance, you may still be worried, because the Budget wording says that an IR35 status determination by the client will not 'automatically' trigger a review of earlier years; in other words, the possibility cannot be ruled out.

However, IR35 investigations into PSCs are very time consuming – they are invariably carried out after the event, and it is difficult for HMRC to obtain reliable evidence of all the detailed facts necessary for them to challenge your IR35 status. That is the main reason why there have been so few IR35 enquiries – and also the main reason why the government has moved responsibility for deciding whether IR35 applies from the PSC to the clients. It is a lot easier for HMRC to visit a bank, and check whether they made all their IR35 decisions correctly, than to investigate hundreds of individual PSCs.

In the majority of cases is therefore likely that HMRC will not have the resources to investigate earlier years. Instead, as the Budget announcement says, they are more likely to concentrate on making sure clients operate the new rules properly.

INCOME TAX GENERALLY

In the past, you could work out your income tax position by knowing (a) the personal allowance, and (b) the point at which your income was taxed at the 40% higher rate, and for high earners, the 45% additional rate.

But things are now more complicated. This briefing first explains the personal allowance and the rate bands, as well as the interaction between the two. It then discusses the special rules for savings income and dividends.

The position of Scottish taxpayers may be different and falls outside the scope of this briefing. Welsh taxpayers are likely to see changes in 2019-20, but these have not yet been announced.

THE PERSONAL ALLOWANCE

The personal allowance in 2018-19 is £11,850. The Chancellor had previously announced that it would rise to £12,500 by 2020-21. The Budget brought this forward by a year, so the personal allowance will be £12,500 in both 2019-20 and 2020-21.

THE HIGHER RATE THRESHOLD

In the past, increases to the personal allowance have often been irrelevant to those on middle incomes, because the higher rate threshold was reduced at the same time. You had more tax-free income, but paid more tax at the higher rate, so there was no overall benefit.

However, not only has the personal allowance increased for 2019-20, but the point at which higher rate tax becomes payable will also go up £3,650 (see the table). As a result, the higher personal allowance will benefit everyone whose income is £100,000 or less.

If your income is over £100,000 your personal allowance is gradually withdrawn. For every £10 over that threshold, you lose £5 of personal allowance. This means that for every £10 of extra income, you pay tax at 40% and lose a personal allowance worth 20% – so the marginal tax rate is an eye-watering 60%.

That means the increased personal allowance isn't great news for those with incomes over £100,000. The 60% band will stretch to claw back the allowance – so this year you will pay an effective marginal rate of 60% on income between £100,000 and £123,700. Next year you will pay 60% on income between £100,000 and £125,000.

TABLE: PERSONAL ALLOWANCES AND TAX BANDS

	2018-19	2019-20	Increase
Personal allowance: no tax on first….	£11,850	£12,500	£650
20% tax on next…	£34,500	£37,500	£3,000
40% tax (the 'higher rate') payable above…	£46,350	£50,000	£3,650
Personal allowance clawback above…	£100,000	£100,000	
Effective 60% rate from £100,000 to…	£123,700	£125,000	£1,300
The 'additional rate' of tax above £150,000	45%	45%	

VAT REGISTRATION THRESHOLD

The government has also been considering whether to lower the VAT threshold – the point at which businesses have to start charging VAT on their services. The current threshold is £85,000, the highest in the EU: the average is £20,000. In November 2017, the Office for Tax Simplification suggested that it might be a good idea to reduce the threshold, possibly to £43,000.

Small businesses operating below the current £85,000 threshold were worried. A reduction would not only increase the charges they have to make to their clients, but also oblige them to comply with all the red tape required by VAT law.

However, the Chancellor announced that there will be no change for the time being, and that the VAT threshold will instead remain frozen at £85,000 for the next two years. However, it remains possible, perhaps even likely, that the threshold will be reduced in the future.

TAX ON SAVINGS

Most people are entitled to a Personal Savings Allowance ('PSA'). The amount of your PSA depends on your 'adjusted net income'. This is your total taxable income (including dividends) less certain tax reliefs, for example gift aid donations and pension contributions

- If your adjusted net income is up to £46,350, your PSA is £1,000, so you can receive £1,000 of savings income, tax-free.
- If your adjusted net income is between £46,251 and £150,000, your PSA is £500, so you can receive £500 of savings income, tax-free.
- If your adjusted net income is over £150,000, you have no PSA, so all your savings income is taxable.

The interaction between the PSA and the basic, higher and additional rate thresholds means that an extra £1 of income can cause you to lose part or all of your PSA, see the example James and John. This example is based on one provided by the Low Incomes Tax Reform Group (LITRG), a charity which helps low income taxpayers.

In addition to the PSA, there is also a special 'savings rate', but that is unlikely to be relevant if you are working full-time. The government provides guidance here.

EXAMPLE: JAMES AND JOHN

In 2018-19 James has adjusted net income of £46,350. Of this, £1,000 is savings income.

The basic rate tax threshold is £46,350, so James is a basic rate taxpayer. As a result his PSA is £1,000.

He is not entitled to the savings rate because his total non-savings income is £45,350. This is more than the limit of £17,850 so he cannot benefit from that 0% rate.

His savings income is taxed as follows:

£1,000 @ 0% = £0

In the same year, John has adjusted net income of £46,351, including £1,000 of savings income. This means he is a higher rate taxpayer, so his PSA is £500. Like James, he is not entitled to the savings rate because his non-savings income is more than £17,000.

His savings income is taxed as follows:

£500 @ 0% = £0

£499 @ 20% = £99.80

£1 @ 40% = £0.40

Tax on John's savings income is £100.20.

NATIONAL INSURANCE CONTRIBUTIONS (NICS)

In order to work out the overall impact of the Budget changes on income, you also need to consider NICs.

In the current year, 2018-19, an employee's earnings between £8,424 and £46,350 are subject to 12% NICs, with a further 2% on earnings above that. The self-employed pay 8% on earnings in the same band – between £8,424 and £46,350.

In 2019-20, the top end of the band will rise to £50,000, to match the point at which higher rate tax becomes payable, see the Table. In other words, the Chancellor has given you a tax savings with one hand, but taken some NICs back with the other.

The self-employed also pay Class 2 NICs. In 2015 the government announced that these were to be abolished, but abolition has been repeatedly delayed. This year's Budget documents state that Class 2 will not be abolished 'during this Parliament', so it looks like they are here to stay.

DIVIDENDS AND THE DIVIDEND ALLOWANCE

Dividends are added to your other income and form the top slice of that income. The tax you pay on the dividend depends on whether you are a basic, higher or additional rate taxpayer.

The Budget did not make any change to the taxation of dividends, so the position is expected to be the same in 2019-20 as it is at present, other than that the thresholds for the basic and higher rate bands have moved, see the Table earlier in this briefing.

In summary:

- The first £2,000 of dividends are taxed at 0% (the 'dividend allowance'). However, they still count towards the basic and higher rate bands.
- To the extent that the dividend is more than the dividend allowance, and falls in the basic rate band, it is taxed at 7.5%, known as the dividend ordinary rate.
- To the extent that the dividend is more than the dividend allowance and falls in the higher rate band, it is taxed at 32.5%, known the dividend upper rate.
- To the extent that the dividend is more than the dividend allowance and falls in the additional rate band, it is taxed is 38.1%, the dividend additional rate.

CORPORATION TAX

The Chancellor had previously announced the corporation tax rate will be reduced from 19% to 18% in 2020. Although there were rumours he might delay this reduction, that didn't happen, so the promise remains in place.

If you are working through a PSC, more profits will remain in your company after corporation tax. And if you are outside IR35, there will be more money out of which you can pay dividends.

EMPLOYMENT ALLOWANCE

The Employment Allowance was introduced in 2014-15. It applied to most businesses and cancelled out the first £2,000 of employer Class 1 NICs. In April 2016, it increased to £3,000, but was no longer available where the director was the sole employee.

Those rules still apply, but this Budget further limits its availability. From 2020, employers whose NICs liability in the previous tax year was £100,000 or more will not be entitled to the Employment Allowance. This change will save the government more than £1bn over the following four years.

The reform is unlikely to affect IPSE members because of the £100,000 threshold, but Employment Allowance is obviously proving an expensive relief, so there may be further cutbacks in future years.

6 SAVINGS

PENSIONS

The Chancellor said before the Budget that the cost of pensions tax relief was 'eye-wateringly expensive'. Many feared that he would announce further reductions to the pensions annual allowance and/or the lifetime allowance.

However, that did not happen. Instead, the lifetime allowance has increased by CPI to £1,055,000. The annual allowance is still £40,000, and the tapered allowance for certain high earners remains in place. There is more about how the taper works at www.gov.uk/guidance/pension-schemes-work-out-your-tapered-annual-allowance.

ISAs

In 2019-20 the adult Individual Savings Account (ISA) annual subscription limit remains at £20,000, while the annual subscription limit for Junior ISAs will be updated in line with CPI to £4,368.

7 RUNNING YOUR BUSINESS

CAPITAL ALLOWANCE

If you buy capital assets, such as equipment, you can usually claim capital allowances. The maximum claim for most assets is set by the annual investment allowance (AIA). The current AIA limit is £200,000, but the Chancellor announced that this will be increased to £1m from 1 January 2019 to 31 December 2020.

If you are planning major capital expenditure (more than £200,000) it makes sense to do this after 1 January 2019 in order to benefit from that higher temporary level of £1m. Remember that cars are not eligible for the 100% relief and have different rules.

TRAINING COSTS

Tax law contains very generous reliefs for training funded by an employer. If you are an employee, and your employer pays for your training, he can deduct the cost for tax purposes, and you pay no tax on the benefit of the training.

However, if you are self-employed, the rules are much tighter. You can only receive tax relief if the training is 'wholly and exclusively' for your job. If, for example, you retrain to learn a new skill, you have to pay for that training out of your after-tax income.

The government has been considering whether to give the self-employed a more generous tax relief for training and issued a consultation document in April 2018.

Disappointingly, the government announced in the Budget that the rules will not be reformed, so it will remain difficult for the self-employed to obtain tax relief on training costs.

8 LETTING PROPERTIES

Many people have purchased property and rent it out. Some have done this instead of saving in a pension, others to supplement their income, and still others originally bought the property for another purpose, such as to accommodate their student children, and later let it to tenants.

A number of recent tax changes have made it less attractive for individuals to be landlords. In particular, mortgage interest used to be deductible in full from the income received by these landlords, but since 2017-18 this relief has been restricted.

The government had previously said it would change rent-a-room relief, which allows you to receive up to £7,500 pa tax free from letting your main residence. Many people use rent-a-room to shelter the rental income they receive when letting their property for a short time, usually via Airbnb or a similar website – perhaps during Wimbledon, a royal wedding, or when they are away on holiday.

According to draft legislation, from April 2019 rent-a-room relief would only have been available if you live in the house at the same time as the tenant – so you couldn't let the whole property and go away. The good news is that in Budget 2018, the government announced that it has decided not to change the rent-a-room rules, so you can continue as before.

However, the Budget contains one further reform. At present, when you sell a let property which has at some point been your main home – known as your 'principal private residence', you can claim a reduction in capital gains tax (CGT).

From April 6 2020, that 'lettings relief' will only be available if you and your tenant both lived in the property at the same time. The government will consult on how the newly restricted relief will work.

9 INSOLVENCIES AND HMRC

If a business becomes insolvent, HMRC is currently an unsecured creditor, so in the same position as anyone else who is owed money by that business.

From April 2020, HMRC will be first in the queue, with a priority right to recover PAYE, employee NICs, VAT and deductions made under the Construction Industry Scheme (CIS) from the assets of the insolvent business.

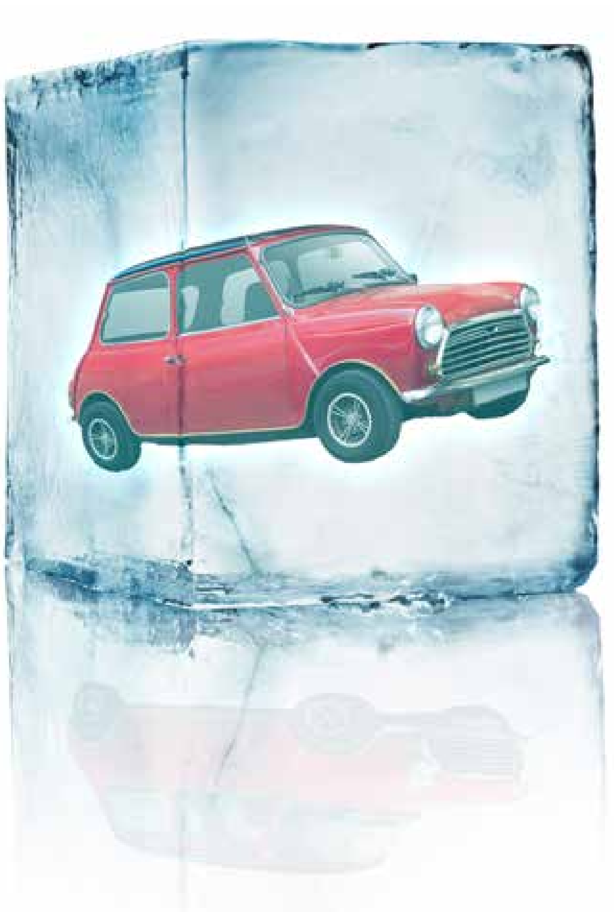
The government's reasoning is that VAT, PAYE, employee NICs and CIS have all been deducted from customers and employees, and so is money held on their behalf. They are taxes collected by the business, not taxes on the business.

In contrast, corporation tax and employer NICs are taxes on the business, and this preferential creditor rule will not apply to them.

The new provision will allow HMRC to recover more money from insolvent businesses – and it follows that other creditors will receive less. So, if you work for a client via your PSC, and your client goes bust, you are likely to get back a lower amount, or nothing at all. The position is different if you were employed by the insolvent business, because employees are also preferential creditors.

And if your business goes bust, and either (a) you have been involved in tax avoidance or evasion, or (b) you set up a new business to replace the old one (known as phoenixism), HMRC will have a new power to collect the missing tax, NICs or VAT from you personally.

10 EXCISE DUTIES



The Budget announced that, for 2019-20:

- Fuel duty has been frozen, for the ninth successive year.
- Vehicle Excise Duty for HGVs will also be frozen, but rates for cars, vans and motorcycles will increase in line with RPI.
- Duty rates on beer, most cider and spirits will be frozen.

Duty rates on all tobacco products increased from Budget day. Tobacco other than hand-rolling tobacco (HRT) has increased by 2% above RPI, with HRT increased by an additional 1%. With effect from 1 July 2019, tobacco used in vaping products will be subject to the same level of duty as HRT.

11 OTHER CHANGES

There is a great deal of material in this Budget, only some of which is outlined in this briefing. If you want to read more about the Budget, the HMRC information can be downloaded here:

www.gov.uk/government/collections/budget-2018

The Treasury information is here:

www.gov.uk/government/publications/budget-2018-documents

12 ABOUT THE AUTHOR

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Anne is a barrister and Visiting Professor in Law at King's College London. She is also a chartered accountant and chartered tax adviser. She is consultant editor to Tolley's Yellow Tax Handbook ('The Yellow book'), the author of IR35, Personal Service Companies and of numerous articles for professional journals. She is frequently quoted in the press and broadcast media and has lectured on tax issues to audiences across the UK.