Tax rises have lead to re-emergence of offshore loan schemes for contractors

In this months Client update, we have had a look at the extra tax the government has imposed on freelancers this year, and warn of an offshore loan scheme that several of our clients have enquired about.

Now that the dust has settled on Labour's local election results we have a clearer view on the political disillusionment and protest voting from the grass roots of our communities. Much of this antagonism has been created by increases in indirect taxation, as well as the headline 10p direct tax band fiasco. In the freelancer community the increase in indirect taxation has included IR35, MSC, Income Shifting proposals, National Insurance increases, Corporate Tax band removal as well as Corporate Tax rate increases from 19 to 22%.

It is this last Corporation Tax increase which will affect our clients. For this year and the next, Corporation Tax is rising by 1%, which in general equates to about £700 per annum of extra tax. On its own, the amount is not a deal breaker, but together with the indirect taxes of the last few years has lead to underground payroll schemes in the freelancer community.

Typically under these schemes, a UK company is put up as the agency facing supplier, through which the billing passes to an offshore company. These companies are offering 90% retention schemes to freelancers by advancing the contractor a loan. The scheme providers charge a very large fee and advise that the loan can be written off and that the freelancer does not have to pay any tax.

Unfortunately, despite the scheme providers' affirmations, UK tax does not work in such a simple manner and although the money can be kept away from HMRC's eyes in the payments process, it does not take them long to identify the schemes and begin their investigations.

As far as tax is concerned, the basic principle in the UK is that earnings generated here must be declared for tax in the UK. The payment of a loan does not remove the requirement for PAYE and NI deductions on the earnings and the recent changes in domicile law means that everyone living in the UK must pay tax on their world wide earnings or pay a large annual waiver of £30 000.

The payment of the offshore loan is in short tax evasion, which is being promoted by the scheme provider and supported by the freelancer. The criminal offence occurs when the freelancer does not declare the income to HMRC at the end of each tax year, and pay the required PAYE and NI on it. For some contractors, the amounts they are hiding amount to £50 000 per annum!

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These offshore scheme providers have been offering their wares for over a decade and generally the freelancer is the party that suffers the most when HMRC catches up with the scheme providers. In the past contractors have lost all their monies where the scheme provider has been investigated by HMRC and have also been charged tax and National Insurance on the earnings they have generated.

Our position on tax efficiency for freelancers is still that the running of your own company, using accountancy and tax expertise, is the most effective manner of trading. Through dividends, legitimate tax planning, company expenses and leaving some money in your company, higher end earners can still retain over 80% of the income they earn from their clients and have a lifestyle which permies envy!

In next month's article, we will look at one of the elements of tax planning and in particular the tax efficiency of your company making a pension contribution for you. We will also look at the importance of Wills for those freelancers with large cash or asset balances in their companies and can assist in their writing and lodging with the High Court.

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