



Nasa Consulting Client Update - June 2008

Tax savings through pension contributions and an IR35 update

In this month's contractor newsletter we discuss tax efficiency as well as how company paid pension contributions can save 43.5% in tax. We have also provided a brief update on an IR35 case that has led to us advising our clients to remove any notice periods in their contracts.

Drawing strategies

Whilst every freelancer has a different lifestyle and drawings requirement from their business, we have done a re-visit here of probably the most tax effective method of trading. Many of our clients use this as a basis for their salary and dividend drawings through their trading year where the maximum taxes suffered are 21%, which is the prevailing corporation tax rate. With expenses and pension contributions, the amount of tax suffered can drop rapidly to around 15%, which is fantastic for the high earning freelance community.

Currently all of a company's profits (income less expenses) are taxed at 21%. Once the company's profits are taxed, they are not taxed again in subsequent years as part of the corporate earnings and form what is called 'retained profits'. However, if an individual draws more than £36,000 from their company as income in any particular personal tax year, then they will be required to pay higher rate taxes of 22.5% on these additional drawings.

For those who like to know the technicalities behind the drawing, the net salary / dividend split is £9,000 / £27,000 as long as you are not caught by the IR35 tax rules. As the monthly salary nets at £750, this means that through the year dividends of £27,000 can be declared without any further tax loss, other than the 21% corporate tax amount.

Exit strategy

In addition to the £36,000 of drawings, freelancers can recover business expenses from their company without further tax. For those earning high amounts, it quickly becomes apparent that a large fund builds up in the company bank account - money for which they would no doubt like an exit strategy! One simple method

is for your company to pay the equivalent of your salary (the £9,000 net salary is equivalent to approx £10,500 gross) as an employer contribution into your pension.

Had this amount been drawn from the company to your personal account it would have incurred £4,350 of higher rate personal tax! There is no tax payable if it is paid into your personal pension fund. Please note we are not advising on personal pensions here, but on the tax relief that can be gained from a corporate pension. We do have a preferred external financial advisor you would like to carry out a company pension contribution into a personal scheme. They will be happy to advise on this regulated area (ask your client manager for the contact details).

IR35 update - notice periods

Of course all of this mega tax efficiency involves being outside of IR35 and not suffering the extra 20% taxes under those rules. At the end of last month, we received details of an HMRC win on IR35. The case involved a contractor trading through his company 'Alternative Book Company' at the same client for seven years! This alone was not the reason that the judge ruled him caught by IR35, but was added to by the fact that the contractor had a one month notice period in his contract.

The problem with this notice period is that it can be viewed as an obligation to carry out work and to be provided work under what is known as Mutuality of Obligation. We are therefore advising our clients that when signing contracts in the future to request that agencies remove any notice periods from the contract.

Regards



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