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Understanding Payment Solutions

What are your Payment Solution options?

IR35 has added to the complexity of taxation legislation and forced many more contractors to seek specialist tax advice. Unfortunately, a lot of this advice can be misleading, offering short-term gains with high risks.

HMRC are actively investigating some of the practices used by contractors to minimise their tax payments and may well examine each of your contracts individually rather than take your earnings as a whole. Therefore, as a contractor you need to be very careful when you choose your payment solution. Below you will find a brief overview of some traditional options.

PAYE

- Using PAYE enables you to avoid the entire IR35 headache.
- Contractors work through an employment agency receiving all income via PAYE.
- Agencies pay a reduced rate as they still have to pay out National Insurance, holiday and sick pay costs, together with the additional administrative burden of running a payroll and complying with current employment legislation.

Crystal Umbrella's payment solutions offer higher net returns than normal PAYE client or agency plus a generous expense allowance and additional benefits.

PSCs (Salary & Dividends)

In the past, contractors used this method to exploit tax loopholes and improve tax efficiency. Contractors set up a limited company and paid themselves via minimum wage and dividends. However, this method is now classed as risky because:

- Inside IR35 dividend payments are not allowed.
- HMRC view minimum wage/dividend option as tax avoidance and may impose PAYE.
- If there is no "goodwill" in the company, contractor may be seen as receiving "disproportionate return on initial investment" and dividend will be taxable as PAYE.
- Outside IR35 if dividend payments takes contractor over 40% tax threshold they will face end of year tax liability.

Umbrella Companies

The umbrella company pays the contractor via PAYE on the total contract sum and uses HMRC approved dispensation for expenses. IR35 is irrelevant as all income is paid as PAYE - so if the contract falls outside IR35 this becomes a less efficient solution.

Crystal Umbrella offers a compliant, low-cost contribution, with added contractor benefits included.

Bonus Schemes

- Contractor is employed by companies and receives basic PAYE salary, usually 20-30% of their contract value.
- Additional bonus payments are made several times a year also net of PAYE.
- This scheme evades some employee NI contributions on bonus and defers payment of some tax and salary.
- Inside IR35 contracts are still liable to tax with deferred taxation paid at PAYE level, resulting in a less tax-efficient solution.

Composite Companies

- The company provides admin services, invoicing and receiving payment for work carried out thus easing the burden for the contractor.
- Contractor is paid a small salary plus expenses, remaining income paid via dividends.

Popular in the past, this option was viewed by the government as 'tax evasion' and new legislation means that it is now illegal and should no longer be pursued.

Employee Benefit Trusts (EBT's)

- Contractor works under company receiving basic salary, usually 20-30% of contract value, with balance paid into an offshore trust from where it is loaned back to the contractor.
- Loan is in foreign currency so avoids IR35, taxation and NI.

HMRC has closed the loophole on this scheme and EBT's are illegal and can no longer operate. Tax relief is now only allowed on PAYE payments made by the trusts, i.e. the lower salary figure, and not on loan.

Offshore schemes

- Money is held in offshore funds to escape taxation.
- Payments made as distributions, loans and dividends.

All income generated in the UK by a UK resident must be declared - whether received or not - and is subject to IR35 criteria and taxation.

For further information please visit HMRC on http://www.hmrc.gov.uk/ir35/ or call us on 0800 848 8888.