

Managed Service Companies

GUIDANCE

on

**Chapter 9, Part 2 and Section 688A, Part 11
Income Tax (Earnings and Pensions) Act 2003**

Index

- 1. Introduction**
- 2. Chapter 9 ITEPA: Managed Service Companies**
 - 2.1 Meaning of a Managed Service Company
 - 2.2 MSC Providers
 - 2.3 MSC Provider involved with the company
 - 2.4 Meaning of Associate
 - 2.5 Worker treated as receiving earnings from employment
 - 2.6 Calculating the Deemed Employment Payment
 - 2.7 Application of the Income Tax and NICs Rules
 - 2.8 Other Matters
- 3. Section 688A ITEPA: Transfer of Debts of Managed Service Companies**
 - 3.1 Debt Transfer Provisions
- 4. Other Issues**
 - 4.1 Additional Guidance for workers
 - 4.2 Additional Guidance for Employment Businesses / Agencies

1. Introduction

Background

In Budget 2007 the Government introduced legislation relating to Managed Service Companies (MSCs): Chapter 9, Part 2 Income Tax (Earnings and Pensions) Act 2003 (ITEPA). The consequence of this legislation is that MSCs treat all payments received by workers providing their services through such companies as income subject to PAYE and Class 1 National Insurance.

Section 688A, Part 11 ITEPA also introduced transfer of debt provisions whereby the PAYE and NICs debts of MSCs, which are irrecoverable from MSCs, can be transferred to third parties.

MSC Providers and MSCs

Key to the legislation is the existence of an MSC Provider involved with a client company. An MSC Provider is defined as *“a person who carries on a business of promoting or facilitating the use of companies to provide the services of individuals.”* “Involved” is defined by reference to any one of five activities.

Service Providers who specialise in providing services to persons providing their services through companies are likely to fulfil the definition of an MSC Provider. Being an MSC Provider **does not** in itself mean that client companies are MSCs and that the MSC legislation applies. For the MSC legislation to apply the service provider must both fulfil the definition of an MSC Provider **and** be involved with their client companies.

It is therefore important that persons are able to determine whether:

- They are an MSC Provider;
- The services provided as a service provider constitute being “involved”;
- A company is an MSC;
- The MSC legislation applies;
- They fall within the transfer of debt provisions and if so how they can mitigate their risk

It is also important that where a person concludes that the MSC legislation applies, they are clear regarding how to apply the legislation.

Who the guidance is aimed at

This guidance is intended for any person operating through a service company, their service provider and parties with whom they do business in order that in the first instance a decision can be made as to whether or not the legislation applies and if it does, how to operate it. Specifically (but not exclusively) it is aimed at:

- Service Providers specialising in providing services to individuals providing their services through companies;
- Accountants, Tax Advisers and other advisers
- Persons providing their services through companies
- Other persons providing services to companies
- Employment Businesses/Agencies

The guidance is intended both to clarify aspects of the legislation where HMRC has received feedback that there is perceived ambiguity, and to make HMRC's position clear regarding its intent to ensure that the legislation meets Government's intent.

2.1 Meaning of a Managed Service Company

N.B References to the singular are to be read as also meaning the plural and vice versa.

For a company to be a Managed Service Company it must fulfil all four conditions of Section 61B (1), Chapter 9, Part 2 ITEPA.

The first condition

The company's business must consist wholly or mainly of providing directly or indirectly services of an individual to third party clients.

The second condition

The individual (worker) supplying their services to the third party client receives payments (or an aggregate of payments and benefits) from the service company equal to the greater part of the sums received by the service company from the client for the services provided by the worker.

The time period for comparison is triggered when a payment is made from the company to the worker, or associate. This time period links with the charging provision, which is given effect when a payment is made.

The intention of the legislation is to compare on a cumulative basis rather than any particular timeframe.

Example:

First payment: assume the company receives a payment for the services of the worker of £500 and pays £300 to the worker or associate. The worker has received an amount equal to the greater part of the amount received for the services.

Second payment: assume an amount of £250 is paid to the worker or associate, which is derived from a receipt by the MSC of £400. The comparison is now £900 against £550, and again the worker has received an amount equal to the greater part of the total amount received for the services.

This comparison will continue as each subsequent payment is made.

The third condition

The payments received by the worker are greater than they would have received if all of the payments were treated as employment income of the worker relating to an employment *with the service company*.

The comparison is performed each time a payment to the worker (or an associate) is made. It is not an annual comparison. The charging provision of the legislation is triggered when a payment is made to the worker or associate; however the legislation will only apply if the company has met the definition of an MSC. It follows, therefore, that the comparison (or test of does the company meet the definition of an MSC) must be performed when the payment is made.

The comparison is between the actual payments received by a worker and the amounts that would have been received if every payment in respect of their services were employment income. The comparison allows for the deduction of expenses which are allowable under the Taxes Acts.

It is the intention of the legislation that the third condition should be considered on the basis that the company through which the worker is operating treats the payments as employment income and applies PAYE accordingly, and the comparison is performed on that basis.

In umbrella companies workers are treated as employees of the umbrella company and all payments to workers as employment income which is paid in the form of salary and allowable expenses. It follows therefore that what the worker has received from the umbrella company is the same as they would have received from any other company through which the worker operated and which treated all payments as employment income. Consequently the third condition is not met and the umbrella company does not meet the definition of a Managed Service Company.

Example:

Miss B provides her services through a service company XYZ Ltd. In the first week of the 2007/08 Tax Year Miss B receives a payment of £575 from XYZ Ltd. The payment has not been subject to Income Tax or NIC, therefore the amount received by Miss B is the same as that paid by XYZ Ltd, which is £575.

The third condition of Section 61B (1) requires a comparison to be made on the amount actually received by Miss B, £575, and the amount she would have received if the sum paid by XYZ Ltd had been treated as employment income and subject to PAYE accordingly.

Taking account of Miss B's personal allowances, the amount of Income Tax due from XYZ Ltd on a payment of £575 employment income to Miss B is

£99.31. By treating the payment as employment income Miss B would therefore have received £575 less £99.31, which is a net sum of £475.69.

The comparison has established that Miss B received from XYZ Ltd a greater payment (£575) than she would have done had the amount had been treated as employment income (£475.69). The third condition has therefore been met.

Note: Subsequent to 6 August 2007 the comparison will also need to take account of the deduction arising for employees Class 1 NIC.

The fourth condition

For this condition to be met there must be person termed an “MSC Provider”, and that person must be involved with the company.

Section 2.2 provides guidance about MSC Providers. Section 2.3 provides guidance about MSC Provides involved with companies.

2.2 MSC Providers

To be an MSC Provider a person must be *carrying on a business* of promoting or facilitating the use of companies to provide the services of individuals.

Meaning of “promotion”

In this context promotion does not mean a person who promotes their business (whatever that business might be), rather it means the promotion of a certain type of product, namely companies to provide the services of individuals. Promotion takes its general usage meaning and includes, amongst other things, such activities as marketing, encouraging, initiating, etc

Meaning of “facilitation”

In this context facilitation takes its ordinary meaning: amongst other things, helping, making easier, enabling etc.

Who is and who is not an MSC Provider

The legislation provides a specific exemption for persons being MSC Providers (involved with a company) merely by virtue of providing legal or accountant services in a professional capacity. This specific exemption applies only to persons professionally qualified (or training for a professional qualification) regulated by a regulatory body.

But simply because a person is not exempt merely by virtue of providing legal or accountancy services in a professional capacity, does not mean that they are an MSC Provider. Persons who promote or facilitate companies generally, as opposed to companies specifically to provide the services of individuals, are not MSC Providers.

The Financial Secretary to the Treasury, John Healey, said in Parliament on 15 May 2007: “The first element that must be satisfied is that a person is carrying on a business of promoting or facilitating companies to provide the services of individuals, not a business to promote or facilitate companies generally. For that reason, those promoting or facilitating companies generally—for example, company formation agents—are not MSC providers. The same would be true of training providers and a number of companies that may provide advice.”

An accountancy/tax adviser, whether or not professionally qualified, who provides advice to clients who are service companies is not an MSC Provider merely by virtue of their client base. The test is whether a person is carrying on a business (or a discernable part of their business) of promoting or facilitating the use of companies to provide the services of individuals.

The Financial Secretary to the Treasury, John Healey, said in Parliament on 15 May 2007:” When an individual asks a tax adviser for help or advice in setting up a business to provide that individual’s services to end users, the tax adviser considers the individual’s position and might recommend a corporate structure that includes the payment of dividends to the individual as a shareholder worker. The tax adviser is not acting as an MSC provider.”

Simply because a person is a lawyer or accountant does not automatically exempt them from being an MSC Provider—the ultimate test is whether a person is carrying on a business (or a discernable part of their business) of promoting or facilitating the use of companies to provide the services of individuals.

Examples:

The following are **not** an MSC Provider by virtue of the activity described:

- A firm of accountants carrying on a business of being accountants (irrespective of the percentage of the client base which is individuals operating through service companies)
- A Tax Adviser carrying on the business of being a Tax Adviser generally
- A Company Formation Agent
- A Chartered Secretary
- An Employment Business/Agency undertaking its core business of placing work seekers (including those operating through companies) with end clients
- Service providers providing services to companies generally, for example insurance companies, payroll bureaux etc.
- A Trade Association operating in the service sector

The following **are** an MSC Provider

- A Service Provider *carrying on a business specifically of marketing and/or providing corporate solutions* and services to individuals providing their services to end clients
- A firm of accountants *carrying on a discernable part of their business specifically to market and/or provide corporate solutions* and services to individuals providing their services to end clients. (In this case the firm would only be an MSC Provider in respect of that discernable part of the business.)
- A business which terms itself a Tax Adviser, Service Provider or whatever but which *specifically markets and/or markets corporate solutions* and services to individuals providing their services to end clients

Back Office Service Providers

The term “Back Office Service Provider” is applied to a number of different types of operations. Whether or not such providers are MSC Providers, or possibly associates of MSC Providers, will depend on the precise nature of their business.

A person who terms themselves a “Back Office Service Provider” and who is carrying on a business of, in addition to providing a range of accounting/bookkeeping services, providing structures (partnerships or bodies corporate) through which workers provide their services, is likely to be an MSC Provider because such a business model indicates that they are in fact promoting or facilitating the use of companies to provide the services of individuals. If this is the case the person must consider whether their business model constitutes being involved with their clients (see section 2.3.)

A Back Office Service Provider who:

- Provides accounting/bookkeeping services exclusively to clients in the service company sector, **is** an MSC Provider because they are *carrying on a business* of facilitating the use of companies to provide the services of individuals ;
- Merely provides accounting/bookkeeping services to clients generally, and not exclusively in the service company sector, is **not** an MSC Provider;
- Merely provides accounting/bookkeeping services to Employment Businesses or Agencies carrying on their core business of placing work seekers with end clients, is **not** an MSC Provider; or
- Acts in concert with an MSC Provider for the purposes of securing that an individual’s services are provided by a company, is an associate of an MSC Provider.

2.3 MSC Provider involved with the company

Simply because a person is an MSC Provider does not necessarily mean that their client companies are Managed Service Companies.

HMRC is aware that there is a market for specialist service providers providing corporate solutions to workers genuinely in business on their own account. Whilst such specialist providers may be MSC Providers, it is important to remember that a key issue is whether the services provided constitute being involved with the client company. To be a Managed Service Company, in addition to fulfilling the first three criterion in section 61B (1) of the legislation, the MSC Provider, or an associate (see section 2.4), must be “involved with” the client company.

Even where some client companies are Managed Service Companies because an MSC Provider (or their associate) is involved with those companies, it does not necessarily follow that all client companies are MSCs if the relationship between the MSC Provider/associate and their clients is *demonstrably* different.

However, the Financial Secretary to the Treasury made very clear in Parliament on 15 May 2007 HMRC’s approach to claims that MSC Provider(or associate)/client company relationships are individually unique: “Where it is clearly a standardised product constituting the MSC Provider being involved with client companies, it (HMRC) will take the starting view that all client companies are MSCs. The onus will then be on the individual companies to demonstrate no involvement.”

“Involved” is defined in the legislation by reference to **any one** of five activities.

The first activity is that of benefiting financially on an ongoing basis from the provision of the services of the individual who provides those services through an MSC. This recognises that fees charged to companies by professionals do not normally have regard to the ability of the workers in the company to generate income: the presumption is that if the company retains the services of a professional, fees will be paid. These will usually vary with the professional services provided and not in relation to the income/profits of the business. (However, see below: *indicators of services that would constitute being involved in all circumstances*: if the professional services provided are directly linked to the worker’s activity, then that would constitute benefiting financially on an ongoing basis from the provision of the services of the individual.)

The above is different, for example, from the person providing services to a company who structures their financial relationship with the company in such

a way that they directly link their fee payment to the worker's income generation.

The second activity is that of influencing or controlling the provision of the services of the worker. The (often compulsory) provision of an engagement contract, dictating /determining the terms under which the worker provides their services or is to be remunerated , are just some examples of exercising influence or control over the worker's provision of their services. Such influence or control is not indicative of a relationship between a Provider and a person genuinely in business on their own account.

The third activity is that of influencing or controlling the way in which payments to the worker or an associate are made. The company's officers should determine how the company distributes its profits. The distribution of profits which conform to a standardised product over which in reality the worker as director has little to no control or influence, is an example of influence or control by the person providing that standardised product.

The fourth activity is that of influencing or controlling the company's finances or any of its activities. A company's officers should, independently of any external influence, determine how the company, as a separate legal entity, and its finances, are administered. Such decisions should have regard to all the relevant factors pertinent to the company and to the company officers' legal obligations. Where there is no such independence, and that is not simply a matter of presenting illusions by some structural changes, HMRC's view is that both the company and its finances are being influenced and controlled.

The fifth activity is that of giving or promoting an undertaking to make good any tax loss. Prior to April 2007 the typical MSC scheme offered the client an "IR35 proof" model. Sometimes that came with insurance, with the guarantee that if HMRC successfully challenged the IR35 proof status of the company, there would be no financial consequence for company or worker.

Where subsequent to April 2007 an MSC Provider or an associate either offers insurance against the tax/NIC *liabilities* arising under the MSC legislation, IR35, or indeed any other provision of the Tax Acts or National Insurance legislation, they will be involved with those client service companies to which they either offer, *or promote*, such insurance.

Meaning of "influences"

In this context "influences" does not mean the provision of advice. The Financial Secretary to the Treasury said in Parliament on 15 May 2007: "there is a distinct difference.....between a person who provides independent, tailored advice to a client, who is then able to consider that advice before accepting it or rejecting it, and the person who simply supplies a client with a standard solution or product that the client accepts."

The fact that an adviser advises a client to incorporate does not in itself constitute “influences”. The advice to incorporate needs to be considered in the wider context of the advice to the client i.e. whether it comprises part of truly tailored advice or in reality constitutes part of a standard product.

In determining whether an MSC Provider or their associate is exercising influence, HMRC will consider all factors in the Provider (or associate)/client relationship and will not accept solely documentation, statutory or otherwise, as definitive proof as to the true nature of the relationship between Provider (or associate) and client.

Meaning of “controls”

The word control takes its normal usage meaning. Following the publication of the Consultation Document “Tackling Managed Service Companies” and draft legislation at the Pre Budget Report 2007, HMRC saw an attempt to circumvent the draft legislation by structural changes: principally the setting up of new companies and the setting up of new company bank accounts. **In determining who is exercising *true control*, HMRC will look beyond structural arrangements and documentation and consider all factors indicative of true control, including the level of understanding of all relevant parties in the arrangements which they are said to control.**

What services are considered to comprise being involved and which are not.

In many cases it is not a simple matter of saying whether a particular service constitutes being involved; rather it is necessary to look at the circumstances, in totality, under which a service is provided. For example, setting up a company for a client as part of a tailored advice would not constitute being involved. However, if the setting up of a company was simply part of a standard non-tailored product then it is highly likely that setting up a company would constitute being involved.

Indicators of services that would generally not constitute being involved:

- **Managing company formation and set up**
If such an activity is undertaken at the request of the client following receipt of tailored advice and is not as part of a standardised product then it does not constitute being involved
- **Acting as the client company’s Registered Office**
If this is done at the request of the client following receipt of tailored advice and is not as part of a standardised product then it does not constitute being involved

- **Registering companies for VAT, CT and PAYE**
 This is an administration function and does not constitute being involved

- **Preparing VAT, CT and PAYE returns.**
 If such activities are undertaken at the request of the client following receipt of tailored advice and are not as part of a standardised product then they do not constitute being involved

- **Providing advice on whether Chapter 8 ITEPA (IR35) applies to a particular engagement.**
 Such advice does not constitute being involved where:
 - ⇒ The Service Provider has had no involvement whatsoever, directly or indirectly, in the engagement contract with any of the parties in the contractual chain ; and
 - ⇒ There is verifiable evidence that the Service Provider, in addition to considering the engagement contract ,considers fully the actual terms and conditions under which the client is engaged: and
 - ⇒ There is verifiable evidence that the Service Provider has challenged inconsistencies in information provided by any party; and
 - ⇒ The Service Provider extends full co-operation to HMRC when so requested in order to determine the accuracy of the Provider's processes,

- **Advising on a remuneration package**
 Providing **advice** to a client does not constitute being involved. But HMRC will consider very carefully whether advice given constitutes genuine tailored advice or in effect constitutes a standardised product. In determining the nature of such advice, HMRC will consider all factors including the nature of advice given to other clients.

- **Advising on expense claims**
 Providing **advice** to a client does not constitute being involved. But HMRC will consider very carefully whether advice given constitutes genuine tailored advice or in effect constitutes a standardised product. In determining the nature of such advice, HMRC will consider all factors including the nature of advice given to other clients.

- **Preparing invoices**
 If invoices are prepared at the request of the client following receipt of tailored advice, relate to services over which the MSC Provider has neither influence nor control, and are not prepared as part of a standardised product, then they do not constitute being involved

- **Submitting invoices to clients of a company**
See above comments

- **Operating a payroll**
If the payroll is operated based on employment income figures notified by the client following receipt of tailored advice and is not as part of a standardised income routing product then, then it does not constitute being involved

- **Preparing weekly/monthly payslips and producing employers' payroll returns, such as P35 & P11Ds**
See above comments.

- **Preparing management accounts and financial statements**
These activities, if provided as part of a tailored service to the client, do not constitute being involved

- **Providing support on secretarial matters, such as drafting of minutes and preparing annual returns**
These activities, if provided as part of a tailored service to the client, and undertaken on the instructions of the client, do not constitute being involved

- **Providing group insurances (including employers and public liability)**
The provision or promotion of insurance services, except for insurance to make good a tax loss, does not constitute being involved.

*Indicators of services that **would** constitute being involved in all circumstances:*

- **Providing a standardised corporate solution package, other than one in which all of the income of all of the persons working through the corporate body, is treated as employment income**

- **Being a director of client companies**

- **Being the company secretary of client companies**

- **Managing the company bank account or the company's finances through a separate account (but see below regarding holding tax balances)**
- **Charging fees based on the number of invoices raised/payroll runs.**
Such a method of charging is indirectly linked to the provision of the services of the worker on an ongoing basis. If the client is being provided with a truly tailored package, HMRC considers that the fee charging arrangement can reflect the individual client needs without being linked (albeit indirectly) to the provision of the services of the worker

*Indicators of services that **may** constitute being involved, depending on the scope of the activity:*

- **Maintaining cash balances on behalf of PSCs to meet CT, PAYE and VAT liabilities**
Whether maintaining such balances constitutes being involved will depend on the circumstances of the case including the precise mechanics of how company funds are transferred, the degree of control truly exercised by the client and what happens to interest accumulated in such holding accounts. For example, if such balances are under the adviser's control and the interest (wholly or partly) is retained by them, then it is more likely that the adviser is involved.

N.B. Balances held in respect of liabilities incurred up to 5 April 2007 and how such balances were accumulated will not be considered in terms of determining whether an MSC Provider is involved with their client. This is subject to the proviso that such balances must be repayable to the client company, on demand, if the client company so demands.

- **Paying CT, PAYE & VAT liabilities on behalf of the PSCs using the cash balances held**
See above comments.

2.4 Meaning of Associate

Associates of MSC Providers

Relevance in terms of being involved

The definition of involved in section 61B(2) (see section 2.3) applies where either an MSC Provider, *or an associate*, undertakes any of the activities set out in the section.

The reference to associate is very deliberate in order that the legislation cannot be circumvented by an MSC Provider arranging for a third party to undertake activities previously untaken by the MSC Provider personally.

For the purpose of Section 61B (2), to be an associate of an MSC Provider a person must *act in concert with that provider for the purpose of securing that the individual's services are provided by a company*. A person acting in concert with an MSC Provider for any other reason will not be an associate for the purpose of Section 61B (2).

Examples:

Not an associate:

- An Insurance company or broker, as part of a wider business of providing insurance, providing insurance to the MSC Provider's clients.
- An Employment Business or Agency, as part of its normal wider business of placing work seekers with end clients, places the MSC Provider's clients with end clients
- A Payroll Bureaux which , as part of its wider business of operating payrolls for clients, operates payrolls for an MSC Provider's clients

An associate:

- An Employment Business or Agency demonstrably in business solely or mainly to place the client companies of an MSC Provider with end clients
- A bookkeeping service demonstrably in business to provide services solely or mainly to the client companies of an MSC Provider

Relevance in terms of transfers of debts

If a person is an associate of an MSC Provider, that also has relevance in terms of the debt transfer provisions. An associate comes within the second category of transferees (see section 3.1) by virtue of section 688A (2) (d).

Associates will therefore be considered for transfer of debts at the same time as MSC Providers are considered.

Associates of persons other than MSC Providers

Associate of the worker

The legislation is structured in such a way that if an associate of a worker receives a payment in respect of the services of the worker, it is treated as if the worker had received the payment (see sections 61B(1)(b), 61B(1)(c) and 61D(1)(b))

For the purpose of associate of a worker 'associate' means:

- a member of the individual's family or household; or
- a relative of the individual; or
- a partner of the individual, or
- the trustee of any settlement in relation to which the individual; or
- a relative of the individual or member of the individual's family (living or dead), is or was a settler.

Note: 'Relative' means ancestor, lineal descendant, brother or sister.

For the purposes of an individual's associate:

- a man and woman living together as husband and wife are treated as if they were married to each other, and
- two persons of the same sex living together as if they were civil partners of each other are treated as if they were civil partners of each other.

Associate of the worker: transfer of debts

Note that for the purposes of transfer of debts, HMRC cannot transfer an MSC's debt to the associate of a worker. This is specifically precluded by section 688A(2)(d) (see also section 3.1)

Associates of other persons

Associates of other persons has relevance in terms of transfer of debt. As with associates of workers, HMRC cannot transfer an MSC's debt to associates of other individuals (e.g. the wife of the MSC Provider's Director) (see section 3.1)

Associate in relation to a company means a person connected with the company.

A company is connected with another company if:

- the same person has control of both; or
- a person has control of one and persons connected with him; or
- he and persons connected with him have control of the other; or
- a group of two or more persons has control of each company, and the groups either consist of the same persons or could be regarded as consisting of the same persons by treating a member of either group as replaced by a person with whom he is connected.

A company is connected with another person if:

- that person has control of it or if that person and persons connected with him together have control of it.

Any two or more persons acting together to secure or exercise control of a company shall be treated in relation to that company as connected with one another and with any person acting on the directions of any of them to secure or exercise control of the company.

Associates in relation to a partnership means any associate of a member of the partnership. Where the partners are individuals the associates of those partners are as under 'Associate of the worker'. Where a partner in a partnership is a company the associates are those as detailed by point 1, 2 and 3 under the heading 'Associates of other persons'.

See section 3.1 for more information on transfer of debts.

2.5 Worker treated as receiving Earnings from Employment

When a company meets the definition of an MSC and where the following applies:

- the services of a worker are provided by a Managed Service Company; and
- on, or after, 6 April 2007 the worker, or an associate of the worker, receives from any person a payment or benefit which can reasonably be taken to be in respect of the services; and
- the payment or benefit is not earnings received by the worker directly from the MSC

the MSC is treated as making to the worker a payment of employment income and earnings in respect of an employed earner's employment.

What this means in practice is that any payment or benefit received by the worker, not already subject to PAYE and Class 1 National Insurance contributions, is liable both to PAYE and (from 6 August 2007) Class 1 National Insurance contributions. For NICs purposes the MSC is treated as the secondary contributor.

It should be noted that the legislation applies irrespective of:

- the nature of the "payment or benefit" (see below);
- whether the payment or benefit is received by the worker or an associate (see section 2.4); and
- whether or not the payment or benefit is made by the MSC

Payment or benefit

A 'payment or benefit' means anything that, if received by an employee for performing the duties of an employment, would be general earnings from the employment.

When a payment or benefit is treated as received

A payment or benefit is treated as received:

- In the case of a payment or cash benefit, when payment is made of the total amount or on account of the total amount;

- In the case of a non-cash benefit, it will be treated as if the worker had been an employee of the MSC and the benefit had been provided by reason of employment.

The date of receipt of the payment or benefit will either be the actual time the benefit is provided, or the tax year during which it was received, in accordance with Sections 19 and 32 of Chapters 4 and 5 Income Tax (Earnings and Pensions) Act 2003.

Deemed employment payment/attributable earnings

The sum treated as earnings from an employment is termed the “deemed employment payment”. The same sum for NICs purposes is termed the “attributable earnings”. Section 2.6 provides guidance on how to calculate the “deemed employment payment”—that is the amount on which PAYE and NICs is due

Example:

Mr. C is an engineer who provides services to a client through his Managed Service Company, C Ltd. C Ltd have an on-going contract with an end client to provide the services of Mr. C.

Subsequent to 6 April 2007 Mr. C receives a payment of £1,000 from C Ltd. The payment has not been treated as earnings from employment of Mr. C. (N.B. irrespective of how the payment is termed: fee, loan, advance, etc. it must still be considered as employment income.)

This has the following consequences:

- C Ltd is treated as making to Mr. C a payment which is to be treated as earnings from an employment
- Mr. C is treated as receiving a deemed employment payment based upon the amount of £1,000
- The deemed employment payment is taxable as employment income. If the payment is made after 6 August 2007 the deemed payment will also be subject to Class 1 NICs as earnings in an employed earner’s employment
- The deemed employment payment is treated as made at the same time as the payment of £1,000 is received by Mr. C,

2.6 Calculating the Deemed Employment Payment.

Introduction

The notional sum paid to the worker (the deemed employment payment) represents both the sum on which PAYE and Class 1 NICs is payable, and the secondary (the employer's) NICs on that amount. Additionally, part of the payment may not be subject to PAYE or NICs if it represents expenses allowable under the Taxes Acts.

In order therefore to arrive at the sum on which PAYE and NICs is due, it is necessary to undertake a deemed employment calculation.

How to calculate the deemed employment payment

Step One	The starting point for working out the deemed payment is the amount received by the worker in respect of services provided by the worker via the MSC and which are not earnings received by the worker directly from the MSC.
Step Two	<p>Deduct any expenses met by the worker that would have been deductible from the taxable earnings from the employment, which could have been claimed as expenses against income tax if the worker had been an employee of the client and had paid for them himself.</p> <p>Note, the expenses met by the worker includes, where the MSC is a partnership and the worker is a member of the partnership, expenses met by the worker for and on behalf of the partnership.</p>
	If the figure you reach at Step Two is nil or a negative amount, then there is no deemed employment. If the result is positive, move on to Step Three.
Step Three	Assume the amount at Step Two represents an amount together with Employers National Insurance on it. Deduct the amount of the Employer's NICs on the deemed payment. It is therefore necessary to calculate the amount, which, together with the employer's NICs on it, equals the result of Step Two.
Step Four	The amount that you are left with is the deemed payment on which tax and NICs are payable

Additional Information

Expenses met by the Managed Service Company

Step Two of the deemed employment calculation provides for a deduction to be made in working out the deemed payment for certain expenses met by the MSC in the year. These are expenses for which the worker could have claimed a deduction against his or her taxable earnings from employment if:

- he or she had been employed by the client to provide the relevant services, and
- had met those expenses out of those earnings.

It is important to note that the normal employment income rules apply when working out whether a particular expense can be deducted at Step Two. These rules are very rigorous and many expenses met by the Managed Service Company will not satisfy them, [see EIM31600](http://home.inrev.gov.uk/eimanual/EIM31600.htm) <http://home.inrev.gov.uk/eimanual/EIM31600.htm> .

It is particularly important to note that when calculating allowable expenses, the worker is treated as being employed by the MSC to provide the relevant services. The practical consequence of this is that expenses (particularly but not exclusively traveling and subsistence expenses) which simply put the worker in a position to undertake the duties with the particular end client are **not** allowable and cannot be deducted when arriving at the sum liable to PAYE and NICs.

Expenses relating to use of a vehicle

A deduction is allowed at Step 2 of the deemed employment calculation for mileage allowance relief if the following applies:

- the worker would have been entitled to relief in respect of the use of the vehicle had they been employed by the client to provide the services, and
- the company was not a company vehicle, and
- the vehicle used is either provided by the MSC for the worker or, where the MSC is a partnership and the worker is a member of the partnership, provided by the worker for the purposes of the partnership

Calculations Prior to 6 August 2007

As explained above, the amount produced by Step 2 of the Deemed Employment Payment calculation is taken to include both the Deemed Employment Payment and the Employer's National Insurance Contribution due on it. Once the NICs legislation is enacted, NICs will be due to HMRC with the Deemed Employment Payment being subject to both Income Tax and NICs.

Until the NICs legislation supporting the tax legislation is introduced there is no requirement to subject the Deemed Employment Payment to employee's Class 1 NIC. This means that the Deemed Employment Payment is only subject to Income Tax.

Until 6 August 2007 there is also no assumed amount of employer's NICs. Consequently any sum prior to that date classed as an assumed amount of employer's NICs is not allowable as a deduction from the company's chargeable profits.

Workers should be aware that if the company does not pay earnings liable to Class 1 National Insurance contributions, and therefore they pay no National Insurance contributions, this may affect their entitlement to state benefits.

How to calculate the deemed payment: step by step guide

The following table provides a step by step guide for working out a deemed payment and secondary Class 1 NICs on that payment:

Step One	Enter in this box the amount received by the worker in respect of services provided by the worker via the MSC and which are not earnings received by the worker directly from the MSC	1	
Step Two	Enter in this box the amount of any expenses met by the worker that would have been deductible from the taxable earnings from the employment, which could have been claimed as expenses against income tax if the worker had been an employee of the client and had paid for them himself	2	
Step Three	Deduct the figure in Box 2 from the figure in Box 1. If the answer is nil or a negative number there is no deemed payment. Where the answer is a positive number you will need to apportion the amount between the deemed payment and employer's Class 1 NICs.	3	
	Enter the amount of employer's Class 1 NICs in this box	4	
Step Four	Deduct the figure in box 4 from the figure in box 3 and enter the amount you are left with in this box. This amount is the deemed payment	5	

Calculating the Employer's Class 1 NIC

The last stage in the calculation of the Deemed Employment Payment is to take the figure at Step Three and apportion it between the Deemed Employment Payment and the Employer's Class 1 NICs due on that payment. This section provides details of the two formulae for doing so.

If, at the time a payment or benefit is received by the worker, the amount of earnings paid by the MSC to the worker is greater than the employer's earnings threshold for Employer's Class 1 NICs at the time the payment or benefit is made, the Deemed Employment Payment is equal to:

- the amount at Step Three multiplied by $100/(100+b)$, where b is the Employer's Class 1 NICs percentage rate

Where, at the time a payment or benefit is received by the worker, the amount of earnings paid by the MSC to the worker is less than the employer's earnings threshold at that date point, the Deemed Employment Payment is equal to:

- $((y-(a-x))*100/(100+b))+(a-x)$, where:

x	=	Earnings to date
y	=	The amount at Step Three
a	=	The Employer's Class 1 NICs earnings threshold at the date the payment or benefit is received by the worker
b	=	The Employer's Class 1 NICs percentage rate

Example 1:

Ms G is a worker whose MSC makes a payment of £300 to her in week 1 of the 2007/08 Tax Year. The MSC also pays earnings from employment of £110, and these have been subject to PAYE. This produces the following figures:

x	=	Earnings to date	110
y	=	The amount at Step Three	300
a	=	The Employer's Class 1 NICs earnings threshold at the date the payment or benefit is received by the	100

		worker	
b	=	The Employer's Class 1 NICs percentage rate	12.8%

As the earnings of Ms G in Week 1 are greater than the Week 1 Employer's Class 1 NIC earnings threshold, the whole of the amount at Step 3 is subject to Employer's Class 1 NIC.

By applying the formula $100 / (100 + b)$ (where b is the Employer's Class 1 NICs percentage rate) we can establish that the Deemed Employment Payment is equal to:

1. The amount from Step 3 (£300), multiplied by
2. $100 / (100 + 12.8)$
3. The result is the amount of the deemed employment payment, £265.96.
4. The amount of Employer's Class 1 NIC is £34.04, which is the difference between the amount at Step 3, £300, and the Deemed Employment Payment of £265.96.

Example 2:

Using the same example as above, however this time Ms G receives no earnings from employment. The only payment received is £300, and this has not been treated as earnings from employment.

x	=	Earnings to date	0
y	=	The amount at Step Three	300
a	=	The Employer's Class 1 NICs earnings threshold at the date the payment or benefit is received by the worker	100
b	=	The Employer's Class 1 NICs percentage rate	12.8%

Ms G's earnings in Week 1 are less than the Week 1 Employer's Class 1 NIC earnings threshold, as she has received no earnings from employment. An

element of the amount at Step 3 will therefore not be subject to Employer's Class 1 NIC.

We must use the formula $((y-(a-x)) \times 100 / (100+b)) + (a-x)$:

1. $((300-(100-0)) \times 100 / (100+12.8)) + (100-0)$
2. $((300-100) \times (100/112.8)) + 100$
3. The result of the calculation is £277.30, and this is the amount of the Deemed Employment Payment.
4. The Employer Class 1 NICs is £22.70, which is the difference between the amount at Step 3 (£300) and the amount of the Deemed Employment Payment of £277.30.

Step by Step Guide

The following table provides a step by step framework for working out:

- the Deemed Employment Payment; and
- Employer's Class 1 NICs on that payment

Enter in this box the earnings to date (a)	1	
Enter in this box the amount at Step Three (b)	2	
Enter in this box the Employer's Class 1 NICs earnings threshold at the date the payment or benefit is received by the worker	3	
Enter in this box the secondary Class 1 NICs percentage rate	4	
Deduct the figure in box 1 from the figure in box 3 and enter the result in this box (e)	5	
Deduct the figure in box 5 from the figure in box 2 and enter the result in this box	6	
Multiply the figure in box 6 by 100 and enter the result in this box	7	
Add 100 to the figure in box 4 and enter the result in this box	8	
Divide the figure in box 7 by the figure in box 8 and enter the result in this box	9	

Add the figure in box 9 to the figure in box 5 and enter the result in this box (c)	10	
Deduct the figure in box 10 from the amount at box 2 (d)	11	

1. (a) this is the amount of earnings paid by the MSC to the worker during the year; including amounts previously subject to PAYE as Deemed Employment Payments
2. (b) this is the amount you worked out at Step Three of the Deemed Employment Payment calculation
3. (c) this is the amount of the Deemed Employment Payment
4. (d) this is the amount of Employer's Class 1 NICs due on the Deemed Employment Payment
5. (e) if the result is a negative number, enter zero in this box

2.7 Application of the Income Tax and NICs rules

This part of the guidance deals with specific points regarding the application of certain Income Tax and NICs rules in respect of the legislation.

For further detailed guidance on the application on the tax rules in general refer to the [Employment Income Manual](http://home.inrev.gov.uk/eimanual/Index.htm) <http://home.inrev.gov.uk/eimanual/Index.htm>.

For further detailed guidance on the NICs rules in general refer to the [National Insurance Manual](http://home.inrev.gov.uk/nimmanual/index.htm). <http://home.inrev.gov.uk/nimmanual/index.htm>

Application of the Income Tax and NICs rules: the deemed employment payment

The Income Tax Acts and the Social Security Contributions and Benefits Act apply in relation to the deemed employment payment as if:

- The worker were employed by the MSC to provide the relevant services, and
- The deemed employment payment were a payment by the MSC of earnings from that employment; and
- The relevant payments or benefits (the deemed employment payment) were a payment of earnings paid to a worker (by the MSC) in an employed earner's employment

Note: Where the MSC is a partnership and the worker is a member of the partnership, the deemed employment payment is treated as received by the worker in the workers personal capacity and not as income of the partnership.

What this means in practice is that the MSC must deduct PAYE and account for Class 1 NICs on deemed employment payments in accordance with the appropriate PAYE and NICs legislation irrespective of how the payment are described, who receives them or who pays them. Further, the MSC must remit the PAYE and NICs to HMRC monthly and submit an end of year return to HMRC recording payments/benefits made during the year and the PAYE and NICs due on those payments/benefits

Application of the tax rules: MSC offshore

Where the worker is resident in the United Kingdom and the relevant services are provided in the United Kingdom, the MSC is treated as having a place of business in the United Kingdom, whether or not it in fact does so. The practical consequence of this is that simply because the MSC is based “offshore” does not render the legislation inoperative. If an offshore MSC fails to apply the legislation, HMRC can determine the PAYE and NICs that should have been accounted for and if that sum cannot be recovered from the offshore MSC, HMRC would invoke the transfer of debt provisions (see section 3.1.)

Application of the tax rules: travel expenses

Step Two of the deemed payment calculation allows a deduction for any expenses met by the worker which could have been claimed as expenses against income tax if the worker had been an employee of the client and had paid for them himself. This may include any travel expenses incurred in respect of relevant engagements.

The legislation treats all engagements as being part of a single employment with the MSC, therefore the rules in respect of travel expenses should be applied on that basis.

Application of the NICs rules: partnership annual earnings periods

Where the MSC is a partnership then Class 2 and Class 4 NICs may be due in addition to any Class 1 NICs in respect of the deemed employment payment. This would normally occur if the partnership was an MSC for part of the year because of its relationship with its MSC Provider but subsequently ceased to be an MSC either because of a changed relationship or changed Service Provider.

Class 4 NICs will only be due if there are any taxable profits remaining after deducting the deemed employment payment. Class 2 NICs will be due even if there are no taxable trading profits.

It is important to bear in mind the maximum total Class 2 and employee’s Class 1 NICs in working out the overall NICs liability which should be remitted to HMRC.

2.8 Other matters

Avoidance of double taxation

The legislation requires a company meeting the definition of a Managed Service Company to treat all payments to workers as earnings from employment.

If, despite the specific requirements of the legislation, an MSC chooses to make dividend payments to the worker, then subsequently treats these payments as deemed payments and performs a deemed employment payment calculation accordingly, a double taxation charge may arise.

To avoid double taxation of amounts treated as deemed payments the legislation provides for a claim for relief to be made. If relief is given for a particular dividend, the recipient does not need to show it in their SA return.

Claims for relief in respect of dividends

In order to avoid double taxation of the deemed payment, the legislation allows for a claim to relief to be made where dividends have previously been made. A claim to relief may be made under this Section where the MSC:

- Is a body corporate,
- Is treated as making a deemed employment payment in any tax year, and
- Either in that tax year (whether before or after that payment is treated as made), or in a subsequent tax year, make a distribution (“relevant distribution”).

A claim for relief under this section must be made by the MSC by notice to an officer of Revenue and Customs within 5 years after 31 January following the tax year in which the distribution is made.

The company should make any claim to the HMRC office that deals with its corporation tax affairs. The claim should include the following information:

- name and tax reference of the company making the claim;
- name and tax reference of the person who received the dividend;

- amount of the dividend paid;
- date the dividend was paid; and
- amount of the deemed payment and the date on which it was treated as paid.

VAT

An MSC only has to register for VAT if the value of its taxable supplies is over a specific limit, unless the supplies are wholly or mainly zero rated in which case an application for exemption from registration can be made. The limit from April 2007 is £64,000.

A Company may voluntarily register for VAT even if the value of its taxable supplies is below the specific limit; however that is a choice for the company.

HMRC operate a Flat Rate Scheme which simplifies VAT accounting by applying a flat rate to VAT-inclusive turnover. The scheme is available to businesses whose annual taxable turnover (not including VAT) does not exceed £150,000. However, any MSC wishing to use the scheme must demonstrate that it is not associated with another business before its application can be accepted.

The flat rates are calculated as an average of the net VAT paid by a particular trade sector. As MSCs do not adhere to a normal sector profile HMRC may refuse use of the scheme in order to protect the Exchequer.

Offshore MSCs (see also section 2.7)

Where the worker is resident in the UK and the work is undertaken in the UK, the MSC is treated as having a place of business in the UK, whether or not it in fact does so. This means that the MSC must apply the new legislation.

If under these circumstances the MSC fails to operate the MSC legislation, HMRC will seek to transfer the PAYE and NICs payable to other persons resident within the UK as set out in the transfer of debt provisions.

Those persons who encourage or are actively involved with Managed Service Companies (see section 3 of the “Guidance on transfer of PAYE /National Insurance contributions debts of Managed Service Companies”) operating from an address outside the UK, inevitably run a higher risk of having the company’s PAYE and NICs transferred to them under the transfer of debt provisions.

3.1 Debts Transfer Provisions

Introduction

The consultation document “Managed Service Companies Transfer of Pay as You Earn and National Insurance contributions debts” set out the difficulties faced by HMRC in collecting PAYE and NICs due from MSCs. Historically, where a liability was established, in practice the debt often could not be collected from an MSC because MSCs generally have no tangible assets making it easy for them to be wound up or simply to cease trading and for workers to move to a new MSC.

In order to address the problem of MSCs escaping their debts in this way, the Government has introduced specific legislation to allow the PAYE and NICs debts of MSCs to be transferred to relevant third parties.

To whom a debt may be transferred

Categories

The legislation (see below) sets out four categories of person to whom a debt can be transferred. The fourth category links to the second and third categories so for all practical purposes there are three categories. In this context person includes an individual, company or partnership. The categories are:

- 1) The director, or other office holder or associate of the MSC;
- 2) The MSC Provider, or the director, or office holder or associate of the MSC Provider;
- 3) Any other person who directly or indirectly has encouraged or been actively involved in the provision by the MSC of the services of the individual, or a director, or other office holder or associate of such a person.

Note that “associate” in this context does not mean an associate of an individual. A debt would therefore not be transferred, to, for example, the wife of the director of an MSC simply by virtue of her being the director’s wife.

Order in which debts will be transferred

Where HMRC certify that an MSC’s PAYE and NICs debt is irrecoverable from the MSC in a reasonable period, all persons within all three categories above become jointly and severally liable for the debt. Irrecoverable in a reasonable period means that if, for example, an MSC with no assets owes £50,000 and offers to satisfy the debt by payments of £500 per month, HMRC would consider the debt irrecoverable within a reasonable period.

It is important to note that this step does **not** mean that all persons will be required to pay the debt. Only where HMRC issues a Transfer Notice specifying a sum is a debt formally demanded of the person served the Transfer Notice (the transferee.)

Transfer Notices must be issued firstly to persons in the first category. If the debt cannot be recovered from such persons, HMRC will then issue Transfer Notices to persons in the second category. Because Transfer Notices must be issued within specified time limits, in practice HMRC will consider the financial position and ability to pay of all persons in both categories simultaneously. If there are no reasonable prospects of recovering the debt from persons in the first category, Transfer Notices will be issued simultaneously to all persons in the first two categories.

Before HMRC can issue Transfer Notices to persons in the third category, it must be impracticable to recover the debt from persons in the first two categories and HMRC must certify to this effect. In practice impracticable may mean a number of things including:

- A person is resident outside the UK and they have no UK assets
- A person has no major assets (e.g. they do not own their home) and legal action is likely to result in the Courts ordering a nominal payment be made weekly/monthly from future earnings

Persons in category three

For persons in the third category the scope of the provision is limited so that the legislation is not intended to include anyone who didn't know, or could not reasonably be expected to know, that they are dealing with an MSC.

Although the legislation specifically exempts two narrow classes of persons from the third category (see below), it is **not** the intention that persons, other than those in the first two categories, have debts transferred to them unless there is clear evidence that they have played an active, rather than passive role in the use of the MSC

The reference to "encouraged" reflects the small number of cases where third parties have very clearly pressed a worker into an MSC, for example by holding out such a structure as the prerequisite to getting a job, or by actively selling the mutual benefits of such a model

The reference to "actively involved", reflects the small number of cases where third parties have contributed to the provision of an individual's services through an MSC. An example of such an instance is a third party placing a worker in such a company without telling them.

End clients therefore who are simply in receipt of the services of a worker providing their services through a company which already existed prior to the worker seeking work with that end client, will not be within the transfer of debt provisions. Specifying, as part of a general policy, that all contractors must be

engaged via a company would not in itself constitute “encouraged”. However, if for example:

- An end client had a *selective* policy of requiring contractors to operate through companies as a result of which a particular contractor approached a provider to set up a company; or
- Contractors not operating through companies were offered advice that providing their services through companies might be more beneficial

then such action would, on the face of it, potentially be construed as encouraging. HMRC would look carefully at the precise circumstances giving rise to the worker operating through a company and whether such a company was an MSC.

The legislation

Section 688A Income Tax (Earnings and Pensions) Act 2003 provides both for regulations to be made to give effect to the transfer of debt provision and set out the framework for transfer of debts. Specifically, section 688A(2) lists the categories of person to whom a debt can be transferred.

Section 688A(3) provides exemption from the third category for persons merely providing legal or accountancy advice in a professional capacity and section 688A(4) provides a similar exemption for recruitment businesses simply undertaking their core business of placing work seekers with clients.

Legal and accountancy advice

The legislation accepts that it is a legitimate function of an accountant and lawyer to offer specific advice, which might well relate to the formation of a company and therefore could be construed as encouraging. For this reason such professional advice is specifically excluded from the transfer of debt provision.

Should a person enter into activities that go beyond the mere provision of legal or accountancy advice in a professional capacity then they will not be within this exclusion and risk coming within the debt transfer provisions. Although providing services which go beyond the mere provision of legal or accountancy services in a professional capacity will exclude a person from the exemption at Section 688A (3), it does not follow that the person will automatically come within the debt transfer provisions. A person needs to consider the services they provide and their interaction with the MSC to establish if they have either encouraged or been actively involved in the provision by the MSC of the services of the individual. See above for definitions of both concepts.

Recruitment Businesses

The legislation also accepts that it is a legitimate function of an employment business/ agency to place individuals with persons who wish to use the services of those individuals. On a number of occasions those individuals operate through companies. For this reason the core business function of employment business/agencies is specifically excluded from the transfer of debt provisions.

Should an employment business/agency enter into activities that go beyond the core business function of placing individuals with persons who wish to use their services, then they will not be within this exclusion, and risk coming within the debt transfer provisions.

Regulations

The Income Tax (Pay as You Earn)(Amendment) Regulations 2007 and the Social Security (Contributions) (Amendment No. 5) Regulations 2007 set out the detail of how debts will be transferred including the grounds on which a person may appeal against the transfer of a debt.

HMRC's approach

Detailed guidance to HMRC staff on how the transfer of debt provisions will operate can be found at www.hmrc.gov.uk/employment-status/msc.htm.

Additional guidance

“Ordinary’ employees “

It is **not** HMRC's intention that debts will be transferred to 'ordinary' employees of the MSC Provider, or indeed 'ordinary' employees of those within the third category (see above). In this context "ordinary employee" means a person who is not a shareholder, and who does not hold a management position or any position of influence.

Composite company workers

There will be several worker/shareholders in an MSC which is a composite company. Transferring the full amount of an MSCs debts to each individual worker would, in most cases, be unreasonable. The debt transfer regulations enable HMRC to have regard to the degree and extent a person has been involved in the provision of the services, therefore HMRC would, as far as is practicable, restrict a transfer notice to an amount which equates to a worker/shareholders involvement.

The transfer of debt regulations also have a specific right of appeal on the grounds that the amount stated in the transfer notice does not have regard to the degree and extent to which the transferee has encouraged or been actively involved. Under such grounds of appeal the Special Commissioners may reduce the amount specified in the transfer notice to such amount as in their opinion is just and reasonable.

Spouses etc

A debt **cannot** be transferred to the associate of an individual. Spouses, common law partners, children etc cannot have a debt transferred to them merely by virtue of their personal association with a transferee.

4.1 Additional guidance for workers

The nature of Managed Service Companies is such that many workers may not:

- Realise that they are in fact being paid through a Managed Service Company; or
- Fully understand whether the nature of the relationship between their company and their provider is such that their company is an MSC.

The below Questions and Answers are intended as a guide to answer more basic questions. However, because whether a company is an MSC is determined both by the nature of the provider's business and their relationship with their client companies, ultimately in determining whether a particular company is or is not an MSC will depend on the individual facts of the case.

If a person has any doubt regarding the status of the company through which they provide their services, they are recommended to seek independent professional advice.

Q. What is a “Managed Service Company” (MSC)?

A. An MSC is a form of intermediary company through which workers provide their services to end clients. The definition of an Managed Service *Company* in the legislation encompasses ‘composite companies’, ‘managed personal service companies’, Limited Liability Partnerships, and general Partnerships.

In essence a scheme provider promotes the use of these MSCs and provides the structure to workers. The worker, although a shareholder (or partner), does not exercise control over the company.

Q. How can a worker tell if they are working through an MSC?

A. If they are not paid directly by the agency, the client or the person engaging, and if:

- they are paid via a limited company; and
- someone else manages and administers the company ; and
- the worker is paid partly in salary and partly in dividends; and

- a fee is deducted from the income paid by the agency, client or person engaging.

Then the worker may be working through an MSC. If they are a director of the company, they have *personal* responsibility for various obligations under company law regardless of the fact that the company may have been set up and run wholly on your behalf.

Q. If a worker works through an MSC, what has changed?

A. The MSC must deduct Income Tax (PAYE) and (from 6 August 2007) NICs on all payments the worker receive relating to work done through the company. Even if the MSC does not directly pay the worker, the MSC must still deduct PAYE and NICs.

Q. What is the tax liability for individuals providing their service through an MSC?

A. Individuals are required to pay PAYE from 6 April 2007 and from 6 August 2007 NICs also.

Q. If a person works through an MSC what should they do?

A. The legislation does not mean that workers cannot continue to provide their services through MSCs; it simply requires that PAYE and NICs is applied to payments received for work undertaken through the MSC.

Q. What if an MSC complies with IR35?

A. If a service company falls within the new definition of an MSC, IR35 no longer applies. Instead the new MSC legislation must be applied.

Q. Does the legislation apply to all persons providing services through a company?

A. No., only those providing their services through companies (or partnerships) which meet the definition of an MSC.

If a person is in doubt they should check with their accountant or the adviser who arranged for the company to be set up.

Q. Are Personal Service Companies (PSCs) affected?

A. No. However, it is important to understand that simply because a company is called a “Personal Service Company” does not mean it is outside the MSC legislation. True Personal Service Companies are not influenced or controlled by their providers.

Workers should satisfy themselves that the business of their provider and the nature of the relationship between their company and the provider are such that they do not fulfill the definition of an MSC.

If a worker is in any doubt, they should check with their accountant or the adviser who arranged for the company to be set up.

Q. Has IR35 changed?

A. No. The Intermediaries legislation (commonly known as “IR35”) remains in place, unchanged, for PSCs. The Government has removed MSCs only from the scope of IR35.

Q. If a worker works through a company which is not an MSC can they claim the cost of travel and subsistence relating to contracts?

A. The rules for PSCs are unchanged.

Q. What should a worker do if the company provider tells them that they are not affected by the new legislation?

A. If the worker has any doubt they should seek independent advice. If the worker’s company is affected by the legislation and the company fails to apply it, the worker can be held personally liable for the company’s PAYE and NICs debts.

Q. Does the legislation mean that a worker cannot obtain comprehensive accountancy support in running their company?

A. No. A worker/director may still obtain comprehensive accountancy support. But HMRC considers that there is a clear distinction between comprehensive

accountancy support to a PSC, and involvement with an MSC by an MSC provider.

4.2 Additional guidance for Employment Businesses and Agencies

HMRC recognises that Employment Agencies and Employment Businesses may be concerned that their core business of placing work seekers with end clients may bring them within the scope of the legislation.

Neither Chapter 9 ITEPA, nor section 688A ITEPA, catch Employment Businesses or Employment Agencies carrying on their core business. There are specific exclusions in both sets of legislation for such businesses.

Nor will the legislation be applied to Employment Businesses or Employment Agencies which undertake services which are merely ancillary to the core business.

However, if an Employment Business or Employment Agency:

- Demonstrably carries on a business of providing structures (companies or partnerships) through which workers provide their services, and provides services to those companies/partnerships to the extent that they would be considered to be “involved” as described in section 61B(2), then that Business/Agency would be an MSC Provider; or
- Demonstrably acts in concert with a person who is an MSC Provider for the purposes of securing that an individual’s services are provided by a company, then that Business/Agency would be an associate of an MSC (but see preferred supplier list question below); or
- Demonstrably encourages an individual to operate through an MSC and/or beyond the mere placing of the worker’s company with end clients and functions directly linked to such placing, or is otherwise actively involved in the MSC’s provision of the worker’s services, then that Business/Agency would potentially render itself liable for the transfer of any PAYE/NICs debt of the MSC.

Below are frequently asked questions about the legislation as it affects Employment Businesses and Employment Agencies.

Q. Will Employment Agencies/Employment Businesses be required to deduct PAYE and NICs as a result of this legislation?

A. Not as a direct consequence of this legislation. However, client workers presently operating through MSCs may choose to seek work via your business in an individual capacity in which case you will need to decide whether the “Agency legislation” applies or not.

Q. Could an Employment Business or Agency be an MSC provider?

A. Employment Businesses and Agencies are specifically excluded from the definition of an MSC provider to the extent that they do no more than an Employment Business/Agency would normally do in pursuit of its business of finding work seekers work. However, a person who demonstrably carries on a business of providing structures (companies or partnerships) through which workers provide their services, and provides services to those companies/partnerships to the extent that they would be considered to be “involved” as described in section 61B(2), would be an MSC Provider; or

Q. If an Employment Agency/Business is considered to be an associate of an MSC Provider, what are the consequences?

A. Firstly, the fact that an Employment Agency/Business is an associate of a person promoting and facilitating the use of companies to provide the services of individuals, might mean that that person is considered to be involved with the company (in accordance with section 61B (2)) even though they are not themselves doing any of the things set out in section 61B(2).

Secondly, as an associate of the MSC Provider, the Employment Agency/Business would fall within the first rank of debt transfer parties, effective from August 2007.

Q. Are service providers who provide accounting, bookkeeping and payroll services exempt from the MSC legislation?

A. The first test is whether a person is carrying on a business of promoting or facilitating the use of companies to provide the services of individuals. If they carrying on such at business, they are an MSC provider and the tests at 61B(2) need to be considered – are they ‘involved’ with the company?

Q. What information can an Employment Agency /Business provide to workers without running the risk of having debts transferred to it?

A. HMRC has produced a simple leaflet that can be distributed by Employment Agencies/Businesses and any other interested parties to workers seeking more information see the “Legislation & Associated Documents) section of HMRC’s MSC website). The leaflet refers the worker to this site which will be updated periodically. See also “what can I ask/tell a work seeker” (below).

Q. If an individual – who operates through a company - approaches an agency, what should an agency look for to see if this company is a PSC or MSC?

A. Other than under the terms of the Construction Industry Scheme (CIS), where gross and net payments are a factor, there is no requirement for Employment Agencies or Businesses to determine the tax status of a limited company.

Q. Can Employment Agencies and Businesses operate preferred supplier lists?

A. Referral of workers to preferred suppliers does *potentially* increase a Business/Agency’s risk in terms of transfer of debt. However, HMRC does not wish to discourage the use of “preferred supplier lists” as it recognises that these have a legitimate function.

In determining whether referral by an Employment Business/Agency of a worker to a preferred supplier *might* constitute encouragement, HMRC will consider all of the facts relating to that referral to establish whether the underlying motive was that of encouraging the worker into an MSC. For example, HMRC would consider whether the Employment Business/Agency had taken reasonable steps to satisfy itself regarding the status of the provider (subject to the fact that limited information is available to an Employment Business/Agency.)

To help Employment Businesses/Agencies decide whether a preferred supplier *may* be an MSC Provider, HMRC has produced “Indicators of whether a service provider may be an MSC provider” (see below).

What can I ask/tell a work seeker

Work seeker already operates through a company

Q. Do I need to establish whether the company is an MSC or PSC?

A. No. If the work seeker approaches an Employment Business/Agency and already operates through a company, including one that the Business/Agency may have been instrumental in arranging before 6 April 2007, then there is no need to ask any questions as to the nature of the company. (The mere engagement of an MSC would not in itself render you potentially liable to the MSC's debts.)

Q. If I know, or I am told by the worker, that their company is an MSC, can I still arrange work for the work seeker?

A. Yes. Provided that you are merely contracting with an existing company and not one through which you have, since 6 April 2007, encouraged the work seeker to operate.

Work seeker does not operate through a company

Q. Can I explain to a work seeker that different pay rates apply depending on whether they work through a limited company, direct through the Employment Business etc?

A. An Employment Business/Agency can provide factual information only without commenting on the merits or otherwise of a particular payment model. It should point out that each payment model has different tax, National Insurance and contributory benefit implications. If the work seeker needs more information, they should seek independent advice.

Q. Can I explain to a work seeker that a particular end client will only engage work seekers operating through limited companies?

A. An Employment Business/Agency can provide factual information only. If certain clients will only engage workers operating through companies, provided that those end clients are relevant to the work the work seeker is seeking, then such a statement would be the provision of factual information.

Q. Can I advise a work seeker that a particular type of engagement model would make them more "saleable" in the market place?

A. This is not advisable, as it may well stray beyond the provision of factual information. It is acceptable to set out the various engagement models and the different pay rates relating to them. But an Employment Business/Agency should point out that each payment model has different tax, National

Insurance and contributory benefit implications. If the work seeker needs more information, they should seek independent advice.

Q. If a work seeker asks what the best engagement model is, can I tell them?

A. No

Q. If a work seeker asks how they arrange to work through a limited company, what can I tell them?

A. An Employment Business/Agency can refer them to a preferred supplier or preferred supplier list but this by its nature carries some risk if the preferred supplier is an MSC provider. See list of high level indicators as a way of mitigating this risk.

General

Q. What questions can I answer from work seekers without running the risk of having a debt transferred to me?

A. You can answer any question posed to you provided that the answer is factual, it does not express an opinion, and it is not designed, nor could be interpreted as designed, to encourage a work seeker.

We recommend that you do not stray into answering factual questions which go beyond those within your competence. For example, detailed answers on the tax consequences of various options available to work seekers are best avoided.

Q. If I discover that a company on my preferred supplier list, which I was satisfied was not an MSC provider, has become an MSC provider, do I need to advise existing work seekers being supplied to me by the preferred supplier to find themselves another service provider?

A. No. It is unlikely that you will be in a position either to categorically determine whether a preferred supplier is an MSC provider or whether their client companies are MSCs. You should however draw the work seekers' attention to the MSC legislation.

If you refer new work seekers to a preferred supplier company you know/believe to be an MSC provider, you potentially expose yourself to being liable for an MSC's debt.

Indicators of whether a service provider may be an MSC provider

Questions to consider

1. Do all of the companies the service provider supports have a unique identifier? (e.g. John Smith (well known provider) Ltd, Pete Brown (well known provider) Ltd.)

2. Does the service provider determine, or seek to determine, terms and conditions relating to the client company, or individual? e.g.:

- Format of contract
- Payment arrangements
- Payment rates
- Invoicing arrangements
- Terms under which the individual will work

3. Is authority for any aspect of the company's trading/provision of the individual's services, delegated to the service provider, e.g.:

- Receipt, or payment, of company funds (particularly payment into a common bank account.)
- Contractual arrangements

4. Does the service provider interpose themselves between the individual /company and the Recruitment Business in any other way whatsoever

5. Does the service provider interpose themselves between the individual/company and the client in any other way whatsoever

6. Does the service provider only support service company clients

7. Is the individual work seeker unable to change service provider and retain their company

If the answer to any of the above questions is "yes", particularly questions 2, 3, 4 and 5, the service provider may be an MSC provider

