APSCo Update on Legal & Compliance Issues

APSCo United Kingdom

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Do not fall foul of the Managed Services Company rules

What is Managed Services Company Legislation?

The Managed Service Company (MSC) legislation, Chapter 9 of Income Tax Earnings and Pension Act 2003 (ITEPA) which was amended in the Finance Act 2007, was created to target the use of contrived corporate structures, which provided contractors with the tax benefits of working through a limited company, but without the responsibilities.

Before the introduction of the 2007 rules, some contractors became shareholders in 'composite schemes', in which they had little day-to-day involvement, but would be paid in dividends and minimal salaries. The scheme provider would manage and operate the company and take care of the bank account, all invoicing and payments. HMRC claimed that such schemes encouraged the avoidance of significant amounts of tax and National Insurance contributions. The 2007 MSC rules were created to prohibit the use of such tax avoidance schemes.

Similar to the Off-Payroll working rules, if the MSC rules are deemed to apply, then the limited company's income will be categorised as employment income and subject to income tax and National Insurance Contributions.

What is a Managed Service Company (MSC)?

An MSC is a form of a personal services company through which workers provide their services to their clients. For a company to be an MSC, it must fulfil all four of the following conditions of section 61B(1), Chapter 9, Part 2 ITEPA:-

1. The company's business must consist wholly or mainly of providing, directly or indirectly, services of an individual (the contractor) to third party clients.

2. The individual (the contractor) supplying their services to the end client receives payment from the company equal to the greater part of the sums received by the company from the end client, for the services provided by the individual (contractor).

3. The payments received by the individual (contractor) are greater than they would have received if all the payments were treated as employment income of the individual (contractor) relating to employment with the company.

4. There must be a 'Managed Service Company Provider' involved with the company.

If an intermediary company is defined as an MSC within the legislation, all of its income will be taxed under PAYE rules regardless of the IR35 status of the engagements.

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What is a Managed Services Company Provider (MSCP)?

The five following tests define an MSC provider as being 'involved with the company':-

1. It benefits financially on an ongoing basis from the provision of the services of the individual. For example, it invoices for services of an individual and then pays this income to the limited company, less its administration fee.

2. It influences or controls the provision of those services. For example, it is involved with the arrangement of the contracts for service, the negotiation of rates and/or terms of the contract.

3. It influences or controls the way in which payments to the individual (or associates of the individual) are made. For example, it has access to the company bank account, or makes any payments.

4. It influences or controls the company's finances or any of its activities. For example, it calculates how much a contractor has earned, and instructs the contractor on how much to pay themselves.

5. It gives or promotes an undertaking to reimburse any tax loss. For example, introduces a contractor or the company to an insurance scheme, guarantee, or protection from the loss of the payment of tax where they are challenged by HMRC.

It is not necessary for all five tests to be relevant for an MSC Provider to be 'involved with the company'. It is possible for only one of the above to be applicable.

Who is liable if the MSC rules apply?

The contractor will be liable should HMRC find that the MSC rules apply.

Due to the transfer of debt arrangements included within the MSC legislation, an MSCP or any other entity involved in setting up the arrangement within the supply chain could potentially be liable for any taxes owed by the MSCs where the MSC is unable to pay the debt.

Important case

In Christianuyi Ltd & Others v HMRC, HMRC was successful in arguing that Costelloe Business Services Ltd was an MSC Provider. Some of the key factors were that Costelloe Business Services Ltd :-

- Benefited financially on an ongoing basis from the provision of the services of the individual and

- Influenced/ controlled the way in which payments to the individual were made.

How to reduce the risk of the MSC rules applying?

Contractors should:

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- Ensure that they control and operate their own companies.
- Ensure they make all the decisions for their company even if they make the final decision after seeking professional advice, as appropriate.
- Issue all invoices and make all payments for their company.

What to do if you get a MSC determination letter from HMRC?

Due to statutory time limits and to protect HMRC's right to recover tax, HMRC have sent letters to some contractors alleging that their Personal Services Companies are in fact, Managed Service Companies.

If you receive such correspondence from HMRC:-

- Do not ignore this. The determination must be appealed within 30 days of date of issue. Please seek legal and financial support as appropriate.
- Check if you have fee protection insurance in place as it may cover fees for challenging HMRC in respect of their determination.
- Ensure that HMRC offset any tax already paid against any further tax claimed.
- Where you disagree with a PAYE determination, you can request a review by HMRC or appeal directly to the tax tribunal. If you believe you have been overcharged you can request to postpone payment of the full amount of the tax pending determination of the appeal.

If you have any queries, please contact the legal helpdesk at legalhelpdesk@apsco.org.

This Update is for information only, includes our opinion and is not legal advice.