

Managed Service Companies

How do the new rules affect you?

Protecting and promoting the interests of consultants, contractors and freelancers

In the 2007 Budget the Government introduced measures to remove the tax advantage offered by "Managed Service Companies" (MSCs). They came into force on April 6th.

There has been a lot of confusion about what the new rules will mean for freelancers and contractors. To clarify the situation, PCG considers the most frequently asked questions.

What do the new rules say?

- under the new rules, "Managed Service Companies" (see box) will have to deduct full PAYE and NICs on all income paid to their contractors
- this must be done irrespective of whether or not the contract in question is caught by IR35

Does my own limited company count as a MSC?

- no: genuine limited companies are not within the definition

What is a "Managed Service Company"?

Typically a MSC (sometimes "composite company" or Managed Personal Service Company") works by making a contractor a shareholder in a company structure: the contractor then works for a succession of clients and is paid in a mixture of salary and dividends. Dividend payments attract a more favourable tax treatment: some MSCs therefore advertise that they allow workers to keep up to 78% of their gross pay.

The new laws give a detailed definition of what constitutes a "Managed Service Company". All companies within this definition must apply the new tax rules when making payments to contractors.

Does my accountant count as a "scheme provider"?

- no: the legislation states that professional accountancy services are not within scope
- "professional accountancy services" are not defined in the legislation, but it is clear that HMRC are not targeting ordinary limited companies and their accountants; PCG expects this to be reinforced by case law in due course

Does an Umbrella company count as a MSC?

- no: PAYE Umbrellas are not within the definition
- contrary to some early reports, expenses policies operated by Umbrellas will be unaffected by the new rules
- the new rules only apply to income that is not "employment income": expenses paid by umbrellas count as "employment income" and so are not affected

My MSC claims it will be able to get round the new rules – will it work?

- we know that HMRC are keeping a close eye on MSCs who claim to have found ways around the new rules

A company is a MSC if it meets ALL of the following criteria:

- it supplies the services of individual workers to a client
- the payments made by the company to workers are in proportion to the services they have provided
- these payments are more than they would be if they were employment income
- a MSC scheme provider is involved with the company

A "company" in this sense can include schemes utilising partnerships and Limited Liability Partnerships also.

Exemptions are provided for recruitment agencies and the professional provision of legal and accounting services.

- typically these involve changing their offering to "accountancy services"
- several providers have decided that this approach will not work and switched all their contractors to PAYE Umbrellas
- PCG advises that sticking with a scheme provider claiming to be able to get round the new rules is the most risky option available: you could well end up as part of a test case

What legal form should I use to go contracting?

- if you're not likely to spend a long time contracting, or are willing to sacrifice tax rewards for the convenience of not having to run your own business, you should probably use a PAYE Umbrella company
- if you're serious about contracting as a long-term career choice and wish to be fully in business on your own account, you should probably set up your own limited company

How can PCG help?

- PCG offers a fully-compliant Quality Umbrella:
www.pcg.org.uk/qualityumbrella
- PCG offers a quick and easy service to obtain a limited company and everything else you need to set up in business at competitive rates:
www.pcgonestop.org.uk

What is PCG doing about the proposals?

- PCG has had extensive contact with the Treasury on this issue
- The Treasury and HMRC have repeatedly stated explicitly and unambiguously that ordinary limited companies are not within the scope of this measure

