

Contractors should tread cautiously with their providers

Are scheme providers clear about the new [Managed Services Company \(MSC\) legislation](#) and what it means for their customers? John Thomas, CEO of the Professional Contractor's Group (PCG) doesn't think they are: "Some bodies are misreading the new legislation and offering contractors, agencies and clients poor advice as a result," he says.

HMRC has confirmed its view that "the legislation is not intended to, nor does it, encompass service companies used by those genuinely in business on their own account and the accountancy services provided to such companies. The legislation addresses the discrete issue of those seeking to avoid employed levels of tax and NICs by providing services through a company which is promoted and facilitated in a way that is quite distinct from professional accountancy services."

Says John Chaplin, Director of Taxes at [KPMG LLP](#): "Many service providers seem to be relying on the so-called accountancy exemption as a reason for not accounting for PAYE/NIC under the proposed MSC legislation. In my view, it's naive to believe that the Treasury would allow a loophole whereby PSC service providers could claim that by merely being a member of an accountancy body, or employing an accountant, that they would be exempt from the legislation."

Some scheme providers had initially attempted to get round the new rules by creating thousands of individual Personal Service Companies (PSCs) through which to pay their contractors. Giant's recent announcement that it is abandoning PSCs altogether and switching all its contractors to a PAYE umbrella is evidence that this approach will not work.

However, Head of Business Tax at [James Cowper](#), Chris Lee is not convinced that scheme providers have been trying to get around the rules by creating PSCs: "That was the approach taken by some following publication of draft legislation in last year's pre-Budget report. However, possibly as a result of that approach, there were significant changes in the version of the legislation announced in the Budget and 2007 Finance Bill. The legislation now seems likely to stop the use of PSCs within a scheme - which is why providers such as Giant have moved entirely to PAYE umbrella companies," he says.

The PCG advises all contractors currently with an MSC whose scheme provider has assured them that their tax treatment will not be affected by the new rules to switch to a genuine limited company or a PAYE umbrella. This is sound advice according to David Hewison, an adviser on MSC matters at [Smith & Williamson](#), who maintains that contractors have now realised this and are voting with their feet: "Genuine limited companies, whether they are referred to as PSCs or not, are unaffected by the new rules. We believe there has been a large surge in the number of companies being registered over the last few months, ever since the discussion document was produced. Presumably people are backing out of their MSC arrangements and are going back to taking the risk on [IR35](#)," he says.

Some scheme providers are continuing with MSCs until the MSC National Insurance Regulations take effect, probably from August 2007. From now until then, there does appear to be a continued saving through the continued use of MSCs, although a lesser saving than under the pre-MSC legislation.

There have also been suggestions from various advisers that dealing offshore may get around the legislation. "I don't think this route will work either," says James Cowper's Chris Lee. "An MSC is still a MSC, even if its scheme provider is offshore. A particular problem here is the transfer of debt provisions within the MSC legislation. If the MSC fails to pay its tax, HMRC will look to others to pay - and if the scheme provider is offshore and out of the firing line, it makes it more likely that agencies will be caught."

Another option is to ask the client to take you on self-employed terms without a PSC. This transfers the risk to the client. Says Chris Lee: "It's a possibility but not very likely. The prime reason for using companies is that it takes the responsibility away from the client. You can be reasonably secure paying a limited company and not have any comeback on yourself. This is also making the assumption that you are genuinely employed in the first place. This is a huge area in itself."

Ultimately, contractors need to understand precisely what structure they are being asked to enter. "If scheme providers are saying managed companies are not MSCs, other than for umbrella companies, contractors need to understand the basis for this and the extent to which they might be at personal risk," concludes Lee.

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David Hewison - Smith & Williamson

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