

Contractors hit by managed service company legislation

ContractorCalculator, live from the London Treasury:

Chancellor Gordon Brown announced no major changes to legislation penalising [Managed Service Companies \(MSCs\)](#) in his Budget speech today.

Despite Brown's stress on UK prosperity and improved investment, contractors are to be attacked and penalised by stringent legislation.

Some small changes have been introduced into the original legislation announced last December. The Government is amending the definition of an MSC to give greater certainty; narrowing the scope of the debt transfer provision; and delaying its application to certain third parties.

Commenting on the Budget, [Mark Prisk MP](#), Conservative Shadow Minister for Business and Enterprise, said: "This measure follows Gordon Brown's attack on the self-employed under the IR35 regulations. It will cost sole traders another £350 million in tax, a fact the Chancellor failed to mention in his Budget speech. It's another stealth tax attack."

The exact definition of an MSC will be released by the Government tomorrow. Watch this space for further comment.

The Government has also promised to amend the debt transfer legislation to make clearer that those simply in receipt of the services of a worker operating through an MSC are not within its scope. The agencies can breathe a sigh of relief that they will not be held responsible for MSC tax debt until January 2008.

"This is most welcome as it will give agencies and clients a chance to make the necessary organisational changes before the legislation kicks in," says John Kell, political analyst for the London-based [Professional Contractors Group](#) (PCG).

Commenting on the Budget, Group CEO of [Charterhouse Group International](#), Eugene Lantry said: "It is clear that the Treasury have listened to the feedback provided in the consultation period. Charterhouse is all too aware of the concerns being raised by the owners of recruitment businesses and their anger at being dragged into the situation that was not of their making."

John Chaplin, Tax Director at [KPMG](#) was expecting some changes to the proposed legislation to make it more difficult for organisations to avoid the 'spirit' of the draft legislation published last year.

"As we feared the new rules may penalise those for whom they were not intended, we urged the Government to delay the new provisions for a further year, to allow innocent businesses and individual workers time to rearrange their affairs," says Richard Mannion, National Tax Director at [Smith & Williamson](#). "We were afraid these proposals would adversely affect existing service companies established for sound commercial reasons and which have no particular focus on tax savings."

However, despite Brown's stress on UK prosperity and improved investment, contractors are to be attacked and penalised by stringent legislation. Brown insisted on 'flexibility' in the economy, and increased investment in science nonetheless, but contractors are to suffer.

Those contractors not caught within the new MSC legislation and running Limited Companies will still be hit, with the surprise shock rise in the small companies corporation tax rate from 19% to 20%.

This is a major blow to contractors, particularly those who are looking to enter the industry. There are many permanent workers who consider contracting, and prefer to dip their toes for a while before committing to a long term contracting career. "Since the draft legislation was published there has been a huge number of company incorporations," says Chris Lee, Head of Business Tax at [James Cowper](#).

For those individuals setting up a Personal Service Company (PSC) is not a viable option in the short term. Therefore, even for some first time contractors outside [IR35](#), they will be taxed as employees.

The Government has seriously under-estimated the number of contractors using MSCs who are outside the legislation. The dramatic ramp up in company incorporations clearly shows that contractors are going back to the [Limited Company](#) model.

Says Dave Chaplin, CEO of ContractorCalculator: "The Government is failing to recognise the middle ground between being employed and being a business owner - that of a contractor. Contractors don't want to be treated like employees, and don't want benefits, and with the extra risk they carry from being a contractor certainly don't want to be taxed as an employee without all the securities and benefits that goes with it."

HMRC is now gearing up to attack those providers that it considers to be acting outside of the law. "I can only see that any legislation will help support this drive. What remains unknown is the knock-on effect to other 'innocent' small businesses," says KPMG's John Chaplin.

PCG's deputy chairman Chris Bryce commented: "Although PCG's contact with the Treasury has produced this clarity there will still be contractors who will be confused about their future: they should seek advice immediately and ensure that they are using either a genuine limited company or a high quality PAYE umbrella, both of which are clearly outside the scope of the new rules."

[David Gauke](#), Conservative MP for South West Hertfordshire says: "Today's announcement is not a surprise; rather it is a continuation of the fundamental lack of understanding of the contracting industry that the Government has displayed since IR35."

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Dave Chaplin is a former IT contractor in the City of London, and is founder and CEO of ContractorCalculator, and author of the Contractors' Handbook.

Started in 1999, ContractorCalculator (this site) is the leading independent website for the UK contracting industry – most of whom are highly skilled knowledge workers. [Read Full Profile...](#)

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