

Proposed changes to managed service companies - explained

Introduction

In yesterday's Pre-Budget report the chancellor said "I am also addressing avoidance and the rules governing managed service companies."

The detail of this statement and proposed new legislation is contained within the 72 page Treasury document '[Tackling Managed Service Companies](#)' released with the Pre-Budget report.

Who do the proposed measures target?

When [deciding on a payment structure](#) for their finances contractors have two choices:

1. [Setting up their own limited company.](#)
2. [Joining a contractor umbrella scheme.](#)

Contractors caught by [IR35](#) typically use a PAYE umbrella scheme, and pay full PAYE and NI on their income, with the umbrella company paying full employers NI.

Contractors not caught by IR35 who use an umbrella often choose providers that have options to pay them via a combination of a low salary and dividends, thereby significantly reducing the amount of PAYE and NI paid. This structure saves the time and hassle of setting up a limited company themselves but enables them to receive the financial benefits of a corporate structure.

Some contractors use a [Composite Contractor Umbrella Scheme](#) which includes them as one of many workers within a limited company structure, whilst others use a 'Managed Service Company' which positions them as a single worker in a company. Both of these arrangements are being targeted by the Chancellor.

Why the new measures?

Currently Managed Service Companies (MSC) are within the scope of the Intermediaries Legislation ("IR35") introduced in 1999. This means that those workers using a MSC structure and are caught by IR35 should be paying full PAYE and NI, rather than receiving income via salary and dividends. According to the Government many schemes have not been enforcing these laws, with many workers evading taxes they should be paying.

Two specialist compliance teams were set up by HMRC in 2003 to focus on MSC schemes. However, enforcing IR35 has posed problems with MSCs. Due to sheer numbers of workers within these schemes (estimated at 240,000 in 2005-2006) and the contract-by-contract approach required by the legislation the sheer numbers of cases makes it impractical to tackle on a large scale. In addition with tax liability being paid retrospectively after the end of the tax year, where there is non compliance, HMRC has to establish liability after the events, which is very hard to enforce given the transient nature of many workers. Finally, even when liability has been established many schemes close down and start up new ones, and since the MSC company has no assets no debt can be enforced against the company and the taxes cannot be collected.

In addition to the measures targeting avoidance of tax, the Government also expressed concern that some workers were forced into using MSCs, rather than being an agency worker, without realising they would lose employment rights such as holiday pay and maternity leave.

What are the new measures and when will they come into force?

The new legislation will enforce all Managed Service Companies to pay their workers via salary only to ensure that all workers are subject to full PAYE and NI taxation. This is identical in nature to an existing contractor being caught by IR35.

Currently there is draft legislation contained within the Treasury document '[Tackling Managed Service Companies](#)'.

The Government proposes to introduce legislation in Finance Bill 2007. It will go into force after the Finance Act receives Royal Assent. The intention is for the changes to take effect from 6th April 2007.

What is the financial impact on contractors?

Contractors who are caught by IR35 but not paying full tax will be forced to do so.

The financial impact of IR35 is significant. For example, a contractor on £50 per hour, earning income via the salary/dividend route takes home 21% (£1000 per month) more than a contractor caught by IR35. To determine the effect on you personally use our [IR35](#)

[Calculator.](#)

The measures also include clauses to prevent workers within these schemes claiming travel expenses for travelling to/from their home to their place of work. For workers with large travel expenses this represents a further loss on income since travel will need to be paid from post taxed income.

The legislation also includes many measures to transfer the debt recovery to third parties, together with wide reaching rules governing who is liable for the unpaid tax. Contractors who have been in one of these schemes and intentionally avoiding IR35 taxes as a result could become liable for the tax they have avoided in the past.

The new measures are not targeting existing contractors who use their own limited companies (Personal Service Companies - or PSCs), since the existing legislation (IR35) already covers that scenario.

What should contractors do now?

All contractors are advised to speak to their providers to ensure they are paying the correct amount of tax given their situation.

Those contractors caught by IR35 and using one of these schemes should consider taking immediate action to get themselves outside of the scope of IR35. See our dedicated section on [Avoiding IR35](#)

Whilst the measures have not yet become law, those contractors NOT caught by IR35 who are using one of these schemes should consider moving either to a PAYE umbrella option, or setting up their own limited company.

Published: Thursday, December 07, 2006

[Tweet](#)

© 2011 All rights reserved. Reproduction in whole or in part without permission is prohibited. Please see our [copyright notice](#). If you want to use any content you have seen on this site then please [request our media pack](#) and ask for details of our Content Licencing Service.

Readers Comments...



Be the first to comment on this article

Also of interest...

Related News:

- [What is a composite company umbrella?](#)

Related Guides:

- [Setting up a limited company for contracting](#)
- [What is IR35?](#)
- [IR35 Rules: How to determine if your contract passes IR35](#)
- [Limited company or umbrella – deciding on a payment structure](#)
- [Moving From An Umbrella to a Limited Company](#)
- [What is a PAYE umbrella company?](#)
- [Choosing a contractor umbrella - checklist download](#)

Related Calculators:

- [MSC Legislation Calculator](#)
- [IR35 Calculator](#)
- [Contracting To Permanent Calculator](#)
- [PAYE/NI Net Salary Tax Calculator](#)



ABCe verified website - last audit confirmed **130,682 monthly unique visitors**

© Copyright 2011 Byte-Vision Limited UK. All rights reserved [Copyright notice](#)