

## Contracting legislation: key laws affecting contractors

Contractors are subject to UK laws and business legislation, just like any other small business. However, some legislation is particularly important for contractors. This is because the rules target the contract sector specifically, or contractors are affected disproportionately.

Here are nine key laws and sets of rules affecting contractors:

### IR35 (Intermediaries Legislation)

Often dubbed as the 'contractor tax', **IR35** is a tax law formally known as the Intermediaries Legislation. Introduced in 1999, it is designed to tackle the underpayment of tax caused by 'disguised employment' and it is enforced by HMRC. If a worker is deemed to have all the characteristics of an employee by HMRC applying specific tests of employment, then the worker is caught by the legislation. They then have to pay income tax and National Insurance Contributions (NICs) as if they were an employee, although they do not qualify for employment rights.

### Managed Services Company (MSC) legislation

The **Managed Service Company (MSC) legislation** is designed to remove the tax advantages of using what is known as a 'managed service company', or MSC. This type of company was popular before the law came into force in 2007 because contractors could enjoy the tax saving benefits of a low salary and high dividends from a limited company without the responsibility of actually managing it. The MSC legislation requires any worker deemed by HMRC to be using an MSC, or a service provider that operates like an MSC, to pay income tax and NICs as if they were an employee.

### Agency Workers Regulations (AWR)

Introduced in October 2011, the **Agency Workers Regulations (AWR)** are designed to ensure that agency workers receive the same conditions and pay that permanent employees enjoy. Some provisions come into force on day one and most others, such as equal pay, take effect after 12 weeks. They only apply if an agency is involved – contractors working direct for the client are out of scope. Limited company contractors are also not within the scope of the legislation, even if an agency is involved. However, umbrella company contractors are in scope. Service providers typically offer umbrella contractors pay between assignments (also known as the Swedish Derogation model) or matched permanent pay solutions.

### Conduct Regulations

The **Conduct Regs**, or to give them their full title The Conduct of Employment Agencies and Employment Businesses Regulations 2003, are designed to ensure contractor recruiters are delivering minimum standards of service to contractors and their clients. However, one of the first requests an agency will ask of a limited company contractor is that they formally opt out of the regulations, so agencies do not actually have to comply with some of the more onerous requirements. The regulations are also designed to apply to contractors who are 'controlled' by their client, so there is a strong argument to suggest that genuine contractors should opt out anyway.

### Onshore Employment Intermediaries: False Self-Employment legislation

The **False Self-Employment legislation** does not actually target limited company and umbrella company contractors. It is tax legislation designed to tackle perceived abuses by self-employed sole traders within the construction sector. It says that employment intermediaries, such as agencies, must deduct income tax and NICs via Pay As You Earn (PAYE) from gross pay unless it can be proved that the worker is not under the supervision, direction and control (SDC) of the client.

Of greater importance to contractors is the **Onshore Employment Intermediaries Reporting Requirements Legislation** that took effect from April 2015. This requires employment intermediaries such as agencies to record and report to HMRC detailed personal and pay information about the directors of contractor limited companies they hire on behalf of clients. It also requires contractors who subcontract work to other contractors to act like they are intermediaries, and to record and report on the contractors they sub work out to.

### Settlements legislation (Section 660/Section 624)

Also known as the 'family business tax', the **settlements legislation** is supposed to prevent **income splitting**. This is when high earning contractors share their income with a lower earning or non-earning spouse, partner or family member to make use of their tax allowance. HMRC tried and failed to extend the legislation, elements of which date back to the 1930s, to spouses in the famous Arctic Systems case. HMRC lost, so contractors can share their company shares and income with a spouse without falling foul of these rules, but they have to be very careful about how they go about income splitting.

### Off-Payroll Rules

Although not actually formal legislation, the **Off-Payroll Rules** were introduced in September 2012 by HM Treasury and apply to contractors working for public sector clients. Any contractor earning more than £219 a day or on an assignment lasting more than six months must prove to their public sector client that they are not a disguised employee, their tax affairs are in order and up-to-date and they are a genuine contractor in business on their own account. If the

contractor can't demonstrate this, then the contractor must go on the client's payroll, operate IR35 or risk having their contract terminated.

## General Anti-Abuse Rule (GAAR)

Introduced in July 2013 as part of a raft of anti-tax avoidance legislation, the [General Anti-Abuse Rule](#) is designed as a catch-all rule that can be used by HMRC to attack abusive arrangements in general. Although mainly focusing on corporation and income tax, the GAAR can also be applied to capital gains tax, stamp duty and NICs. Contractors will fall foul of the GAAR and may be liable for unpaid tax, interest and penalties if they use a scheme that is purely designed for tax avoidance purposes and has no commercial purpose. Fortunately, HMRC is not the judge and jury – there is a GAAR panel that includes non-HMRC members to determine which schemes the GAAR can be applied to.

## Construction Industry Scheme (CIS)

A scheme introduced in 2004 and designed to combat false self-employment in the UK's building industry, the [Construction Industry Scheme \(CIS\)](#) requires construction hirers/clients to deduct income tax directly from a worker's gross earnings. Again, this scheme is targeting self-employed sole traders who really should be on their client's payroll but it also sweeps up many construction professionals who are legitimate one-person businesses. Construction contractors have to register with HMRC and 20% income tax is deducted by the hirer from their gross fees. Limited company contractors can offset this against their corporate tax liability, and many end up with a rebate from HMRC. Under certain circumstances, it is possible to register with HMRC to receive gross payments in full.

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