

Managed Service Company (MSC) legislation – key guide for contractors and agencies

Contractors, agencies and their clients should be wary of the [Managed Service Company \(MSC\) legislation](#). Contractors found by HMRC to be using a managed service company will be required to pay income tax and National Insurance Contributions (NICs) as if they were employees.

Plus, because the legislation includes 'debt transfer' rules, it means agencies and clients can become liable for a managed services company's unpaid income tax and National Insurance bills. This can happen if the contractor's managed service company does not have the cash to meet its liabilities, or has been dissolved to avoid paying its creditors.

The legislation, which came into force in 2007, is designed to remove the tax advantages of using a managed service company, such as being paid a very low salary bumped up by very high dividends. However, the legislation does not affect [umbrella company contractors](#) or genuine contractors using their own [contractor limited companies](#).

What is a managed service company and an MSC provider?

According to HMRC's [guidance on the MSC legislation](#), for a company or partnership to be a 'managed service company' it must satisfy four conditions:

The company's business must be the provision of a contractor's personal services to end-user clients, or to a client via an agency

The contractor must be paid "equal to the greater part of the sums" of the fees from the client or agency; ie the contractor receives more than the managed service company takes in fees and for overheads

The amount the contractor gets paid is greater than what they would have earned if they'd been employed by the managed service company

There must be an individual who is the "MSC Provider", and that individual must be involved with the managed service company.

An MSC provider is an individual "carrying on a business" to market or facilitate "the use of companies to provide the services of individuals."

HMRC's definition is basically referring to 'composite companies' and 'managed personal service companies' -- those companies that are owned by multiple contractors with varying degrees of share ownership and classes of shares being managed by professional managers, not contractors, who are usually the directors.

The impact of the MSC legislation on contractors

Contractors caught by HMRC working for a managed service company are liable to full Pay As You Earn income tax and National Insurance Contributions (NICs) on their fee income from the managed service company, in exactly the same way as if they were employed by their managed service company.

As the MSC legislation is distinct from [IR35](#), it means that a contractor's contract could be outside IR35 but they could still be paying tax like an employee if working via a managed service company.

In fact, IR35 is slightly more generous than the MSC legislation, as contractors can claim 5% of their fee income as operating expenses, whereas the MSC legislation does not allow for any expenses when calculating tax liabilities.

Debt transfer rules

Unlike IR35, the MSC legislation can have a direct impact on agencies and clients. This is because of the debt transfer rule, which can make agencies and clients liable for unpaid debts that have arisen through the non-payment of income tax and NICs by the managed service company.

For HMRC to enforce the debt transfer rules, the agency or client must be actively involved using contractors working via managed service companies, which includes promoting managed service company schemes.

HMRC will first try to claim unpaid tax and NIC liabilities from the managed service company itself. If that is not possible, it may seek to collect the money from the company directors. Only after trying these routes first will HMRC turn its attentions onto the agency or client.

Although no-one has yet been found liable under the MSC legislation, at the time of writing this article, a recruiter is under investigation by HMRC and may be found liable for up to £10m as a result of the debt transfer rules, suggesting that HMRC is actively policing this area of the law.

Contractor guidance on identifying managed service companies

When the legislation came into force in 2007, many existing managed service company scheme providers claimed they could circumvent the law yet still continue to offer the same sort of services to contractors.

HMRC cottoned onto this quickly and warned contractors to vet service providers, including accountants. HMRC also said that it was monitoring the activities of former managed service company providers, even to the extent of reviewing promotional claims on providers' websites.

Contractor tests to see if contracting service providers are managed service company providers include:

The service provider controls, or attempts to control, the provision of the contractor's services to their client

The service provider controls the contractor limited company's finances and bank accounts

The service provider negotiates contracts with end-user clients and agencies without including the contractor in the dialogue

The service provider insists on becoming a company officer, such as a director or company secretary of the contractor's limited company

The service provider is clearly lax in its attitude to regulation, such as allowing expenses HMRC rules say should not be allowed

There are financial ties between the service provider and the agency or recruitment business that provides work for the contractor

The service provider undertakes any services that influence the control of the contractor's limited company.

Contractors have also been warned to be wary of service providers that sell tax savings as their main benefit.

Certification by industry bodies such as [PCG](#) and trade organisations such as the [Freelancer and Contractor Services Association](#) can help contractors and recruiters to choose compliant service providers.

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