

What is a managed service company?



Please note: As of April 2007, Composite Companies are no longer a legitimate option for UK contractors due to the *NEW* managed service companies legislation.

Visit our [dedicated guide to Managed Service Companies](#) to find out more.

A Managed Service Company, in the context of the definitions defined in the December 2006 Pre-Budget Report, refers to a service company that provides contractors with a composite company solution to manage their invoicing and accounting.

In a composite company scheme, typically up to 20 contractors become non director shareholders and the company is managed by the scheme provider. The contractors are then paid a low salary plus dividends in addition to claiming various expenses allowable under the corporate structure. This method of payment provides many financial benefits, since it avoids large amounts of national insurance and income tax that would otherwise be payable if the contractor was paid entirely by salary.

However, for a contractor to use a composite scheme they must be outside of the **IR35 legislation** - or not 'caught by IR35'. "IR35" is a piece of tax legislation announced in 1999, which took effect from April 2000.

HMRC's intention was to tackle tax and National Insurance (NIC) avoidance schemes through the use of intermediaries, such as Partnerships or Personal Services Companies (PSC). Contractors often use the **Limited Company** as a PSC to obtain work either direct from an end client or via an agency. The Revenue's view was that a large number of IT Consultants, Engineers, non-executive directors and "one man band companies" were often treated as self-employed when in fact they should have been treated as employees of the end Client. This was based on the terms and conditions that the Contractors worked under.

The Revenue argued that if the agency or the PSC were removed, a large number of contractors would really be "**disguised employees**" who should be included on the client payroll and have tax and NIC deducted each month. The Government announced the "rule changes" which would take effect from 6 April 2000.

The Revenue alleges in its Pre-Budget Report that many contractors are operating using composite company schemes via Managed Service Companies, even though their status was certainly one of being inside IR35. They allege that many companies and contractors were ignoring the legislation. Since the Revenue could not effectively challenge all the cases, the new legislation is intended to remove the issue by forcing all MSC contractors to pay tax as though they were an employee of their client, effectively ruling all workers using the scheme into an IR35 caught position.

Those contractors genuinely outside IR35 are expected to form their own limited companies, whilst those caught by IR35 will need to transfer to a simple **PAYE type umbrella** where all income is fully taxed.

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