

## MSC mysteries explained

After much research and taking ongoing advice from many sources, including a number of leading UK tax specialists, Crystal Umbrella would like to help clarify the main points of the Managed Service Company (MSC) legislation and the impact this could have on you. We think it is important to start with explaining the differences between the types of companies that fall within the scope of the MSC legislation and Managed Service Company Providers (MSCP's).

The MSC legislation, which has been in force since April 2007, was brought in an attempt to reduce the "unfair competitive advantage" compared to "compliant businesses and workers". MSC's and MSCP's are bound by the legislation but in themselves are very different.

### Definition: Managed Service Company (MSC)

For the MSC legislation to apply, the company through which the worker provides their services to End Clients would need to be defined as an MSC. The definition of an MSC is contained within the full legislation document and is based on four conditions:

1. The company's business consists mainly of providing the services of individuals to third parties.
2. The individual receives payments that represent the majority of the fees received by the service company.
3. Had all the payments been subjected to PAYE, the payment would have been greater than what it is now.
4. A MSCP is involved with the company.

All four conditions must be satisfied for the company to be classified as a MSC.

These are discussed in greater detail in the section titled 'HMRC Definitions & conditions of the MSC legislation/MSC and MSCP.'

### Definition: Personal Service Company (PSC)

Personal Service Companies (PSC's) are owner managed companies. They are usually set up with one director and one shareholder paying a minimum wage and dividends. The director, often the contractor themselves, is responsible for completing all the relevant Tax and VAT returns as well as all other administrative duties on behalf of the company.

The PSC would raise an invoice to the agency/End Client and it would be for the director to ensure payments and any debt is collected.

Each new contract assignment would have to be analysed according to the HMRC regulations and in the majority of cases, an accountant or tax advisor would need to be engaged to help undertake the contract and working practice analysis and final interpretation.

### Definition: Managed Service Company Provider (MSCP)

A MSC Provider is defined by HMRC as "a person who carries on a business of promoting or facilitating the use of companies to provide the services of individuals and is involved with the company." In this context, 'person' includes the individual, partnership or company. Being an MSCP does not in itself mean that the provider (person or business) is an MSC or that the MSC legislation applies. The acid test is about being 'involved' with the company and in the 'business of promoting or facilitating the use of companies to provide the services of individuals'. HMRC has identified five ways in which an individual can be 'involved' (see section titled Characteristics of a MSCP).

### Definition: Managed Service Companies Legislation

The legislation deems that all payments received by 'a worker engaged by an MSC' to be employment income. This would mean that PAYE (including deductions for Tax and NIC) must be applied to all earned income. January 2008 brought into force the full provisions of the 'Transfer of Third Party Debt' regulations. This means that where an MSC is unable to pay the Tax and NICs, its debt can be transferred to a third party, such as the Agency or the End Client involved with the facilitating or promoting of such companies.

As a result of these regulations, Agencies and End Clients must be clear as to their own internal processes and their understanding in relation to using "limited company contractors," whether through the use of PSC's, or some of the other non-compliant managed solutions that are available to contractors.

In summary, it is important for an Agency or End Client to be able to determine whether a company they wish to use is an MSC by reviewing the four conditions detailed above and the points below:

- Whether the person is an MSCP in any one of the five ways mentioned below.
- Whether the MSC legislation applies to your current situation and whether the Transfer of Third Party Debt rules applies.
- How you can mitigate the risk of being within the MSC and Transfer of Debt rules.

## HMRC definitions & conditions of the MSC legislation/MSC's and MSCP's

HMRC's interpretation is that umbrella companies are NOT MSC's because condition three would not be met. Workers of the umbrella company are employees and receive their salary net of tax and national insurance and allowable expenses. The amount received from the umbrella company is the same as would have been received directly from any other company that the worker would operate through and which would treat all payments as employment income.

## Characteristics of an MSCP

An MSCP is defined as a "person who carries on a business of promoting or facilitating the use of companies to provide the services of individuals, is involved with the company." It is the term "involved" that has created much confusion and concern. The guidance makes reference to one of five activities that can be construed as 'involved':

1. Benefits financially on an ongoing basis from the provision of the services of an individual.
2. Influences or controls the provision of those services.
3. Influences or controls the way in which payments to the individual (or associates of the individual) are made.
4. Influences or controls the company's finances or any of its activities.
5. Gives or promotes an undertaking to make good any tax loss.

An MSCP includes a person or organisation who promotes a product such as a PSC, to provide the services of individuals (contractors) and to assist in the managing of those PSC's or providing services to make the use of those PSC's easier.

## Exemptions

There are some specific businesses and individuals that are not considered to be MSCP's:

- Persons professionally qualified and regulated by a regulatory body.
- Training providers.
- A chartered secretary.
- An employment business placing work seekers.
- Company formation agents.
- A firm of accountants or tax advisors (practising).
- A trade association.

## How Crystal Umbrella is affected

Crystal offers services and provides the services of individuals to Agencies and End Clients. Prima facie, this would mean that Crystal would be treated as an MSCP for the purposes of the legislation. However, as mentioned previously, simply being an MSCP does not automatically mean that the MSC legislation applies.

As an Umbrella company, the third condition of the MSC legislation is not satisfied. All payments made by Crystal Umbrella are treated as employment income. Therefore, Crystal Umbrella is not classed as an MSC. Tax and NI is deducted at source on the whole contract sum in the same method as PAYE thereby ensuring that this payment method falls outside the third condition of the MSC legislation.

## Conclusion

Crystal's payment solution is compliant and does not represent a threat for Agencies or End Clients. Our solution falls outside the MSC legislation as all the income is subject to the operation of PAYE.

For more information please call us on **0800 848 8888**