

Introduction

Two sets of anti-avoidance rules need to be considered where services are provided by an individual to an end-user via an intermediary. These are the personal service company and managed service company rules.

The personal service company, or 'IR35', rules were introduced to prevent perceived avoidance of tax and national insurance contributions (NICs) where a worker provides their services via an intermediary (generally a personal service company) to an end-client in circumstances such that but for the existence of the intermediary, the worker would be an employee of the client.

- The rules operate such that where an engagement is caught, the income of the intermediary is treated for tax and national insurance purposes as if it were the income of the worker.
- The rules do not impact on the client, who makes gross payments to the intermediary regardless of whether the IR35 rules apply.
- Instead, where IR35 is in point, the intermediary is treated as making a deemed payment to the worker.
- The worker is treated as having received income that is liable to both tax and Class 1 NICs.
- The intermediary is responsible for operating PAYE and NICs on the deemed payment.
- The fact that services are supplied through a one-person company is not in itself sufficient to bring the rules into play.

Guidance on the IR35 rules can be found on the HM Revenue and Customs (HMRC) website at www.hmrc.gov.uk/ir35/index.htm.

Separate rules for managed service companies (MSCs) apply where an individual provides their services through an intermediary that meets the definition of an MSC. Where services are provided through an intermediary, the MSC rules must be considered first. If they do not apply, the IR35 rules must be considered. Guidance on the MSC rules can be found on the HMRC website at www.hmrc.gov.uk/employment-status/msc.htm.

Outline of the IR35 rules

The purpose of the IR35 rules is to prevent avoidance of income tax and NIC on income that is routed through intermediaries. The rules come into play where, if the individual worked directly for the end-user under the same terms, they would be taxed as an employee. The intermediaries are usually limited companies, but the rules also apply to some partnerships. By providing services through an intermediary that is a company and paying dividends rather than salary, NIC (employer's and employee's) savings result.

Background

The use of personal service companies became especially widespread among computer professionals, engineers and lecturers in private sector educational establishments.

- People often entered into contracts for a few months or years to provide services to one organisation, the client. The engagements generally did not meet the conditions for self-employment. The individual therefore set up an intermediary company to avoid being taxed under PAYE as an employee of the client and to save Class 1 NICs.
- The intermediary entered into a contract with the client to provide the services of the individual, and the individual had an employment contract with the intermediary.

- The interposition of an intermediary was also effective where work was obtained through an agency.
- Employment agencies are obliged to make PAYE deductions from all payments to individuals, whether employed or not, but do not have to operate PAYE on payments to companies.
- Tax was saved in the following main ways:
 - A company has greater scope for deduction of business expenses than an employee.
 - The company could save NICs by paying dividends instead of salary. Some of the shares in the company might be owned by the individual's spouse or partner. This could produce a tax saving on dividends if the spouse or partner has little or no other income. The spouse or partner could also be paid a salary for administrative duties or for acting as a director.
 - Although saving tax and NICs was one reason for the growth of personal service companies, the arrangement also suits the end-user, who is relieved of any obligations under employment law (but see page 9, 'Employment law decisions'). However, many professionals still choose to operate through personal service companies and apply the IR35 rules where these are in point.

However, it should be noted that simply providing services through an intermediary does not in itself trigger the application of the IR35 rules, and not all personal service companies are caught. The crucial element is whether, but for the intermediary, the worker would be an employee of the client. It is therefore necessary to look through the intermediary to see whether the worker–client relationship is essentially one of employee and employer.

How the rules operate

The rules make payment of dividends ineffective in saving tax and NICs. In addition, company expenditure outside the permitted expenses is taxable under PAYE, even though it remains deductible for corporation tax purposes.

- The client organisation is not affected by the rules and can continue to pay the intermediary without any PAYE deductions.
- A company might have other income as well as income from relevant engagements. The other income does not have to be included in calculating the amount to which PAYE must be applied.

Who is affected?

The intermediary has to operate PAYE on all income received from a 'relevant engagement', minus some very limited expenses, where:

- The worker, or an associate, receives, or has the right to receive, income from the intermediary that is not taxable as employment income.
- If the intermediary is a company, the worker (and/or associates) owns more than 5% of the company or receives income that represents remuneration for work performed and which is not taxable as employment income.
 - Income therefore does not fall within the rules if it is earned by a company from the work of a genuine employee who is not a shareholder or a relative or associate of a shareholder.
 - This exception allows consultancy companies to make a profit from the work of their employees.

- If the intermediary is a partnership:
 - The worker (on their own or with relatives) is entitled to 60% or more of the profits, or
 - Most of the profits of the partnership come from work for a single client, or
 - The worker's income from the partnership is based on the income generated personally from relevant engagements.
- The effect of the partnership rules is to exempt many partnerships. This includes those consisting of two unrelated partners who share profits equally, and where less than half the income of the business is derived from contracts that would be relevant engagements.
- If the intermediary is an individual, payments to the worker can reasonably be taken to represent the worker's earnings from a relevant engagement.

Relevant engagements

A relevant engagement is one where:

- A worker provides services under a contract between a client and an intermediary, and
- The income would have been taxed as employment income if the worker had contracted directly with the client under the same terms.

The tests for distinguishing employment from self-employment are covered in 'Relevant engagements' on page 6.

Deemed payment – intermediary company

Where an intermediary company receives income from a relevant engagement:

- The intermediary must operate PAYE on actual salary payments made to the worker in the usual way.
- At the end of the tax year, the worker's actual employment income, including benefits, and the permitted company expenses are deducted from the company's income from relevant engagements.
- This excess is treated as being inclusive of employer's NICs, which are deducted to arrive at the amount that is deemed to have been paid to the worker as salary on 5 April.
- The company must account to HMRC for the PAYE tax and employer's and employee's NICs on it.
- The deemed payment is part of the worker's income for tax purposes and is counted as relevant UK earnings for pension purposes.
- No further tax and NICs are due if the worker later withdraws the income from the company as a dividend. This is achieved by deducting the deemed payment from dividends paid in the same or a subsequent tax year.
 - Only any balance of dividends paid is taxable as the worker's income.
 - The company, not the worker, must make a written claim to HMRC for this relief.
- The company may deduct the deemed payment, including the employer's NICs, in arriving at its profit for corporation tax purposes.

- The deemed payment can occasionally arise earlier than 5 April, for example, if the worker leaves the company, or the company ceases trading.
- Where this occurs, the tax and NICs must be paid within 14 days of the end of the PAYE month in which the deemed payment occurs.

Deemed payment – intermediary partnership

Where the worker is a partner in a partnership, there can be no actual salary payments because the worker is not employed.

- The deemed payment plus employer's NICs is the income from relevant engagements less the permitted expenses.
- The amount of the deemed payment is not included when computing the worker's share of partnership profits.

Permitted expenses

Only the following expenses can be deducted in calculating the deemed payment:

- Employer's pension contributions to a registered scheme if they are allowable under normal rules.
- All expenses that would be deductible as employment expenses under the normal rules at the permitted rates for travel in the employee's own car, and any other costs incurred wholly, exclusively and necessarily in the performance of the duties of the employment. HMRC interprets this rule very strictly.
- All employer's NICs as well as the employer's NICs on the deemed payment itself.
- A further flat rate 5% of the income from relevant engagements, regardless of what expenses the intermediary actually incurs. This is intended to cover administrative expenses and running costs.

Example

Mr Brown's company, Brown Ltd, has an 18-month contract to supply engineering services to M plc, starting on 1 March 2009.

Brown Ltd is paid £6,000 a month under the contract, which is a relevant engagement. Brown Ltd also has income from non-relevant engagements of £10,000 during the year ended 5 April 2010.

During the tax year 2009/10, the company has the following costs:

Mr Brown's salary	£20,000
Employer's NICs	£1,828
Pension contributions	£4,000
Allowable expenses related to the relevant engagement	£3,000
Wife's salary	£3,500
Other expenses	£10,000

The calculation of the deemed payment is as follows:

Income from relevant engagement (12 x £6,000)		£72,000
<i>Less</i>		
Mr Brown's salary	£20,000	
Employer's pension contributions	£4,000	
Allowable expenses	£3,000	
Employer's NICs	£1,828	
Flat rate deduction 5% of £72,000	£3,600	£32,428
Deemed payment inclusive of employer's NICs		£39,572
Of which employer's NICs at 12.8% on deemed payment is		£4,490
Deemed payment		£35,082

The intermediary is treated as making a deemed payment of £35,082 on 5 April 2010. The intermediary is responsible for applying PAYE and NICs (employer's and employee's) to this deemed payment.

Relevant engagements

The IR35 rules only apply to ‘relevant engagements’. A relevant engagement is one where:

- The worker personally performs or is under obligation to personally perform services for another person (the client),
- The services are not provided directly under a contract between the client and the worker but under arrangements involving a third party (the intermediary – often a personal service company), and
- The circumstances are such that if the worker were provided under a contract directly between the client and the worker, the worker would be regarded as an employee of the client.

The rules for determining whether but for the intermediary the worker would be an employee of the client are the same as the rules for establishing generally whether an individual is employed or self-employed.

There is no formal definition of self-employment, but a series of tests has been derived from case law over many years. It is only if the individual would be treated as an employee of the client and the other two tests are met that the IR35 rules apply.

Self-employment tests

The overriding principle is that self-employed people have to be in business on their own account. Many factors have to be considered in order to decide whether this is the case. Often, an engagement might show some indications of self-employment but have other factors pointing towards employment. In such a case, one has to look at the overall picture.

In a 1994 tax case, *Hall v Lorimer* (1994) 66 TC 349, the Judge in the High Court said:

“In order to decide whether a person carries on business on his own account, it is necessary to consider many different aspects of that person’s work activity. This is not a mechanical exercise of running through items on a checklist to see whether they are present in, or absent from, a given situation. The object of the exercise is to paint a picture from the accumulation of detail. The overall effect can only be appreciated by standing back from the detailed picture which has been painted, by viewing it from a distance and by making an informed, considered, qualitative appreciation of the whole. It is a matter of evaluation of the overall effect of the detail, which is not necessarily the same as the sum total of the individual details. Not all details are of equal weight or importance in any given situation. The details might also vary in importance from one situation to another.”

In arriving at this ‘overall picture’, the following factors are usually indicative of self-employment:

- The right to send a substitute to carry out the work.
 - This is often considered to be one of the most important tests for personal service companies.
 - Most contracts between client and intermediary specify a named individual to carry out the work.
 - This on its own could make the contract a relevant engagement, because the requirement for personal service strongly suggests employment.
 - However, a purely theoretical right to send a substitute that will never be exercised in practice may not carry a great deal of weight. The decision by the High Court in *Dragonfly Consulting Ltd v HMRC* [2008] EWHC 2113 Ch has made it easier for HMRC

to ignore a 'substitution clause' in a contract if, in practice, substitution would not happen.

- Taking financial risk. If the intermediary's income from the contract is fixed and the intermediary incurs few expenses, little financial risk is involved.
- The possibility of profiting from sound management. Will the intermediary make more money by carrying out the contract more efficiently?
- The right to hire assistants to carry out the contract more efficiently.
- Control over how the work is undertaken.
 - If the contract requires attendance by the individual worker at the client's premises between set times every day, this will be indicative of employment.
 - It should be borne in mind that employed professionals also have a great deal of control over how they perform their work.
- Provision of the person's own equipment.
 - If the intermediary has to provide major items of equipment to carry out the contract, this is an indication of self-employment.
 - Driving in one's own car and providing small items of equipment are not significant.
- Payment for the job rather than a fixed monthly salary.
 - Payment for holidays, sickness and other leave, and provision of expenses and benefits by the client are generally indicative of employment.
 - However, it is not unusual for self-employed professionals in some businesses, such as accountancy, to charge according to time spent on the task.
- A contract to complete a piece of work.
 - This is more indicative of self-employment than a contract that terminates after a fixed term, although it depends on the type of work involved.
- The intentions of the parties.
 - These often form a clause in the contract, and are important but not decisive.
- A large number of short engagements.
 - This is more indicative of self-employment than a single longer contract, especially where the company has to adopt a business-like approach to organising the fulfilment of the engagements.
- The absence of mutual obligations.
 - The courts have held that an employment relationship requires the existence of 'mutual obligations'.
 - These are an obligation on the part of the client to offer work and an obligation on the part of the intermediary to accept and perform the work offered.

Wording of contracts

The wording of any contract between the client and the intermediary will be a strong indication of whether the income arises under a relevant engagement, although HMRC can ignore contractual terms where they differ from the parties' actual behaviour. Artificial arrangements are usually

vulnerable to attack, and at worst contractors and the client could face criminal charges if they deliberately draw up a contract that does not reflect the actual relationship.

- The client might be unwilling to accept a contract that removes the protection afforded by a typical employment-style contract, which would normally lay down a great deal of control over how, and by whom, the work is to be undertaken.
- Depending on the nature of the services to be provided, there might be scope to draw up a contract that falls outside the definition of a relevant engagement.
- The following specific points in the wording of contracts might be helpful:
 - Contracts should avoid identifying an individual worker and allow the intermediary to substitute the worker.
 - The contract could be tied to completion of a project rather than on an hourly basis and subject to notice.
 - The intermediary might be able to profit from greater efficiency and sound management.
 - Terms indicative of employment should be avoided, such as overtime, sick pay, holiday pay and benefits.
 - Clauses that prevent the individual worker from doing other work during or in the period after the contract are unhelpful.
 - Maximum control over how, where and when the work is undertaken should rest with the intermediary.
- HMRC has a procedure for obtaining an opinion on whether the IR35 rules apply to a contract. The intermediary should send the contract to:

IR35 Customer Service Unit
HMRC
Ground Floor North
Princess House
Cliftonville Road
Northampton
NN1 5AE

Telephone: 0845 3030 3535
Fax: 0845 302 3235

- Advice is generally given on existing contracts only. HMRC will not generally give advice on a particular tax year unless all the relevant information is supplied by the start of that year. HMRC will probably ask for additional information and may need to speak to the parties to the contract and others. Where the worker or intermediary does not agree with HMRC's opinion, a formal decision can be requested. A right of appeal to the Tribunal exists in respect of a formal decision. HMRC has not approved any form of model contract. The Professional Contractors Group, a trade body for contractors, strongly recommends that HMRC clearance should not be sought because of the potential costs of contesting a ruling.

Case law

Disputes with HMRC over whether an engagement falls within the IR35 rules are considered by the Tax Tribunals (previously the Special Commissioners) and the courts. There are numerous cases that generally hinge on whether, but for the intermediary, the worker would be an employee of the client. The *Dragonfly Consulting Ltd* case attracted a lot of attention as the court decided that a substitution clause in a contract was not in itself sufficient to prevent IR35

from biting if the reality of the situation is that substitution would not happen in practice. It is therefore unwise to rely on a substitution clause as protection against IR35.

In *Lime-IT Ltd v Justin* SpC 3027, which was heard in 2002, the Special Commissioner decided that a contract was outside the IR35 rules and emphasised the importance of project-based contracts. Other important points were that:

- The contract reflected what occurred in reality.
- The service company incurred financial risk like a business, because there were often delays in receiving payment.
- The worker did not work fixed hours, although the contract specified a 37-hour week.
- The fact that the service company bought a laptop computer to enable work on the project to continue away from the end-user's office was further evidence that the contract was outside IR35, although a minor factor.

There was a genuine right to substitute a different worker. The Commissioner felt that the end-user would have been reluctant to accept another worker in reality. The decision in this case suggests that a contractual right of substitution is not enough on its own to put an arrangement outside IR35.

In *Synaptek Ltd v Young* [2003] EWHC 645 (Ch), which was decided in the High Court in March 2003, a contractor was found to be within the IR35 rules, despite a number of factors that suggested self-employment. In particular:

- The intermediary company was clearly in business on its own account, there was substantial investment in the company and it had engaged employees in the past.
- The contract contained a right of substitution, but it had never been invoked and required the client's consent.
- In favour of 'employment' were:
 - The worker had to put in 37.5 hours a week.
 - The contract was for a fixed period of six months rather than being project-based, ie until completion of the work. This confirms the importance of project-based contracts.
 - The only true business risk was insolvency of the client.

Each case can only be decided on its own facts, and the Commissioners have found in favour of IR35 in other cases.

However, this decision emphasises that it is possible to escape the IR35 rules with a correctly worded project-based contract that reflects the way the worker operates in reality.

Employment law decisions

A number of employment law cases have concluded that while there is no direct contractual link between the client and the worker, the totality of the arrangements created an implied contract between worker and end-user.

As a result of such decisions, some experts believe that such employment law decisions may encourage end-users to be more careful in drawing up contracts to avoid an IR35 challenge. The decisions could be taken to imply that if the worker is caught by IR35, then the end-user will be regarded as the employer, with all the tax, national insurance and employment law implications that would follow.

Categorisation of earners for NICs

National insurance regulations treat certain earners as employees even though they would be self-employed by reference to the general tests. They include entertainers, teachers and lecturers, and office cleaners.

If such a person works for a service company and has an engagement that would not fall within the IR35 rules for income tax, the service company will nevertheless be liable for NICs and a deemed payment calculation must be carried out.

Corporation tax

The rules do not remove the liability of the company to corporation tax, nor do they absolve the company from any other requirements under the Taxes Acts or other legislation.

Calculation of corporation tax

An intermediary company is liable to corporation tax in the usual way, except that the deemed payment is deductible in the accounting period in which it falls. The flat rate 5% expenses rule has no relevance for corporation tax.

	£	£
Gross income (£72,000 + £10,000)		82,000
<i>Less</i>		
Mr Brown's salary and employer's NICs	21,828	
Other expenses	20,500	
Deemed payment plus NICs	39,572	81,900
Taxable profit		100

The corporation tax deduction is given in the accounting period in which the deemed payment is made.

Other points

Worker's tax liability

The way in which the worker's tax liability is met depends on whether the payment is from a company or a partnership.

Company

The deemed payment forms part of the worker's taxable employment income for the tax year in which it arises. Tax will be deducted under PAYE using the tax code issued for the year. If the employee has overpaid tax for the year, a repayment can be made.

Partnership

Where the deemed payment arises in respect of a partner, it will probably be the partner's only employment income. It is unlikely that the PAYE tax code operated will result in the correct tax deduction from the deemed payment. The resultant underpayment or overpayment should be dealt with under self-assessment in the usual way.

NICs

Whether payment is from a company or a partnership, employee's NICs on the deemed payment will be calculated using an annual earnings period. The worker is treated as having been paid the attributable earnings on 5 April at the end of the tax year. The attributable earnings are aggregated with other earnings paid in the tax year, and the liability calculated on the aggregate using an annual earnings period. The amount paid by the worker is the liability for the year, less any amounts paid already on salary payments made during the year.

Accounting for PAYE

The PAYE tax and NICs due on the deemed payment are normally payable on 19 April, 14 days after the deemed payment arises, or 22 April if paying electronically.

- HMRC has offered guidance for companies unable to make an accurate calculation by the payment date. Companies in this situation should make a provisional calculation, pay the tax and NICs based on that, and inform the collector that this is what they have done.
- The company has to submit its annual PAYE return (form P35) by 19 May. If the company can finalise the calculation at that time, it should show the correct figure and pay the difference or request a repayment. Otherwise, the company should make it clear that the figure is still provisional. A supplementary return with a final payment, or request for repayment, should be sent as soon as possible afterwards.
- Interest will run from 19 or 22 April in the usual way, but no penalties will be charged if these procedures are complied with and the provisional calculations are made in good faith.

'Company' cars

The tax rules for benefits in kind do not fit in easily with the deemed payment rules. Where the intermediary provides a car for the worker, HMRC has said that the following consequences will arise:

- If the car is used for business travel, a deduction can be made for the costs of that business travel in the same way as if the worker had their own car, that is, by using the permitted mileage rates.
- Whether travel to the site where the work is undertaken is business travel is determined in accordance with the usual rules for employees. In general, such travel will be business travel if the worker does not expect to spend more than 40% of their working time for more than 24 months at any one site.
- A car provided by the intermediary for the worker's private use will give rise to a car benefit charge on which the worker will be taxed in the normal way. The amount of the car benefit charge can be deducted in calculating the deemed payment.

- The intermediary can set any costs of providing the car, including capital allowances, against its taxable profits.
- Class 1A NICs paid on the car benefit are deductible in the calculation of the deemed payment, together with other employer's NICs.

Other benefits and expenses

- Where an intermediary provides other benefits in kind, such as medical insurance or the use of assets other than cars:
 - The amount on which the employee is taxed in respect of the benefit is deductible in calculating the deemed payment, together with the Class 1A NICs that arise on it.
 - The actual cost of providing the benefit is not deductible in calculating the deemed payment.
- Some genuine business expenses are not deductible in calculating the deemed payment because they do not qualify under the strict rules for employment expenses. For example, no specific deduction is possible for secretarial expenses, accountancy fees, the costs of seeking contracts and some training courses. The cost of professional indemnity insurance is generally deductible.
- If an intermediary company regularly incurs high expenditure of a type that cannot be deducted in calculating the deemed payment, and has little income other than from relevant engagements, it will accumulate corporation tax losses that it will be unable to use.

Failure to apply the rules

An intermediary that fails to account for PAYE tax and NICs on a deemed payment is subject to the usual penalties for incorrect PAYE returns. The maximum penalty for fraudulently or negligently making an incorrect return is £3,000. If HMRC has difficulty enforcing payment by the company, it can collect the amount due directly from the director under existing provisions.

HMRC can look back at past contracts and collect tax on deemed payments for earlier years. If an intermediary is uncertain whether a contract is within the definition of relevant engagements, the safest course of action is to obtain a formal HMRC ruling before the date that the first deemed payment would arise. It is also possible to obtain a general indication by using the Employment Status Indicator interactive tool on the HMRC website at <https://esi2calculator.hmrc.gov.uk/esi>. However, this will not give a definitive ruling.

Employment agencies

The fact that the intermediary might be paid by an agency rather than directly by a client does not affect the operation of the IR35 rules. It is the relationship between the worker and the end-user that must be considered when determining whether the contract is a relevant engagement. However, HMRC will generally wish to see the contract between the agency and the ultimate client in order to determine whether the arrangement is a relevant engagement. As a result, some contractors make it a condition in their agency contract that the agreement between the agency and the end-user contains certain key clauses, eg a right to substitution.

Overseas issues

The location of the intermediary company has no effect on the tax liability on a deemed payment. Whether tax is due on a deemed payment will depend on the residence status of the worker and the location in which the duties of the contract are carried out.

- There is no tax liability if the worker is not resident in the UK in the tax year.
- If the worker is resident but not ordinarily resident in the UK, or is a non-UK-domiciled person working wholly overseas for an overseas client, payments in respect of work overseas are taxable only to the extent they are remitted to the UK.

- If an offshore intermediary fails to deduct and account for PAYE tax and NICs, the liability to pay can be transferred to the worker.
- Action to recover employer's NICs that have not been paid by an offshore intermediary could also include action against any assets of that intermediary located in the UK.
- HMRC has powers to obtain details of payments to offshore intermediaries from the records of clients and agencies.

Working abroad

No deemed payment will arise where the work under the contract is carried out overseas for a client based overseas, regardless of the location of the intermediary company, because the individual would not have been liable to UK tax and NICs if they had been employed directly by the client.

Planning

Individuals affected by the IR35 rules have a number of choices:

- Ensure that a contract with a client is not a relevant engagement. Methods of achieving this are discussed above.
- Stop using personal service companies and work directly for clients. Operation of PAYE then becomes each client's responsibility.
- Work abroad.
- Work within the legislation and ensure that the company does not accumulate unusable corporation tax losses.
 - Pay actual salary rather than PAYE tax and NICs on a deemed payment in order to control the timing of the deduction for corporation tax purposes.
 - Limit company expenses that cannot be deducted in calculating the deemed payment.
 - If possible, arrange for the company to have other income that does not arise from relevant engagements. This will absorb those company expenses that cannot be deducted in calculating the deemed payment.
 - Choose an accounting date of 5 April or 30 April to ensure the deemed payment falls in the same period as all or most of the income on which it is based.
- Charge clients more in order to cover the extra costs. Room for manoeuvre might of course be limited.

Managed service companies

MSCs are mass-marketed companies provided to large numbers of individuals. A company is an MSC if it meets all four of the following criteria:

- The business of the company consists wholly or mainly of providing the services of an individual or individuals to other persons.
- All or most of the income the company receives for providing the services of individuals is paid out to those individuals.

- The way the individuals are paid results in their receiving more than if they had been paid under PAYE.
- An MSC provider is involved in promoting and facilitating the use of the company.

Where a company is an MSC, all payments to individuals providing their services through the company are deemed to be employment income subject to tax under PAYE and NICs. It does not matter what the payment is called. The rules apply even if the payment is described as a dividend. The legislation includes detailed rules for calculating the sum that is subject to PAYE and NICs.

In addition, travel expenses to each engagement are not allowable expenses and cannot be deducted in calculating the sum subject to PAYE and NICs. Where the MSC does not or cannot pay the PAYE tax and NICs due, HMRC can recover it from others in the following order:

- A director, shadow director, other office holder (eg company secretary) or associate of the MSC.
- The MSC provider.
- Anyone else who has been involved in the provision by the MSC of the services of an individual.

The aim of the rules is to make the use of MSCs disadvantageous for providers and the individuals who might use them. If the MSC rules apply, IR35 is not in point. The application of the MSC rules should be considered ahead of IR35.

Tax planning key points

- HMRC has long targeted what it perceives to be avoidance of tax by abuse of the rules. The IR35 rules target those who it regards as avoiding tax by masking the employer–employee relationship by interspersing an intermediary to take advantage of the tax and NICs advantages that arise by paying a dividend rather than a salary.
- Although the basic rate of income tax is now lower than the small companies' rate of corporation tax (20% as compared to 21%), the fact that no NICs are payable on a dividend can generate considerable savings. If the proposed national insurance rises are indeed implemented from April 2011, these savings will increase.
- Following their defeat in the Arctic Systems case in July 2007, HMRC also sought to target some companies not within the IR35 rules that saved tax by paying dividends to a non-working spouse of a director. However, plans to introduce legislation on this area have been dropped for the present.
- Further information on the IR35 and MSC rules is available from:
 - HMRC's IR35 Customer Service Unit (contact details as above on page 8),
 - Any tax office,
 - Any HMRC Enquiry Centre, or
 - The HMRC website at www.hmrc.gov.uk/ir35/index.htm.

This guide is for general information only and is not intended to be advice to any specific person. You are recommended to seek competent professional advice before taking or refraining from taking action on the basis of the contents of this publication. The guide represents our understanding of the law and HM Revenue & Customs practice as at May 2010, which are subject to change.