

MSC rears its head, sparking major concerns among accountants

Compliance expert Seb Maley of Qdos shares the latest details regarding the Managed Services Company legislation

When it comes to tax compliance among contractors, it seems that if it's not IR35, it's MSC-related.

I am of course referring to the complex and confusing Managed Service Company (MSC) legislation, which reared its head in dramatic fashion recently and looks set to remain on the scene for some time to come.

The past couple of years have been relatively quiet on the MSC compliance front, but in March, Qdos was alerted to HMRC launching enquiries into at least 1,000 contractors who the tax office believes have breached the MSC rules.

As many of you will know, the MSC legislation was rolled out in 2007 to stop contractors from perceived tax abuse. Its aim is to prevent a limited company contractor, whose business is controlled by an MSCP, from enjoying the tax benefits of running their own business if the business itself is controlled by another party – effectively used as a vehicle through which to avoid tax.

This latest development regarding MSC is especially relevant to accountants, given HMRC also approached the two specialist contractor accountants that supported these contractors. The tax office is of the opinion that they played the role of Managed Service Company Providers (MSCPs).

You're also no doubt aware that the MSC rules pose a significant risk not only to contractors but to accountancy practices and their directors, along with other parties in the labour supply chain, such as recruitment agencies and even the end client.

In this article, I'll bring you up to speed and run through the latest developments surrounding this murky, vague tax legislation.

What has happened?

At last count, well over 1000 contractors had received letters from HMRC regarding their MSC compliance – by now though, this figure is now very likely in its thousands.

These contractors aren't being investigated per se, they have been sent a blanket letter with a tax liability owed, in many cases in the region of £50,000 for just one tax year. It's a 'guilty until proven innocent' scenario – a needlessly aggressive tactic employed far too often by HMRC.

The tax office is of the view that these contractors have been operating via MSCs, with two well-known specialist contractor accountancies targeted as part of the process.

Needless to say, the tax office's latest activity in this area has sparked fears of widespread enquiries, with many other contractor accountants potentially caught in HMRC's crosshairs.

Collectively, the sums at stake are eye-watering. The sheer number of contractors being targeted and the three years focused on by HMRC (2017 to 2020) means the total liability being pursued could easily run into tens of millions of pounds.

Why must accountants pay attention to MSC?

As touched on briefly, the MSC legislation has the potential to send shockwaves through the contracting sector, not to mention the wider community – whether accountants, recruiters or businesses engaging these flexible workers.

Let's say a contractor's company can't afford a £50,000 tax bill and neither can the director of the business (the contractor themselves). The liability will travel up the supply chain and is transferred to the accountant engaged by the contractor. In a similar fashion, if the accountant's business can't settle up with HMRC, the director or directors of the accountancy will be expected to foot the bill.

Given plenty of contractor accountants engage hundreds, if not thousands of contractors in a similar way – and HMRC is targeting well over 1,000 in the enquiries that we're aware of so far – it goes without saying that this new activity could be financially devastating for everyone involved.

What can accountants do?

In some of the letters sent to contractors that Qdos have caught sight of, HMRC has openly said that it's carrying out MSC enquiries into numerous contractor accountancies – these are the firms that the tax authority suspects to be MSCPs.

So flipping it on its head for a moment, something accountants mustn't do is hope for the best and work off the basis that it's unlikely that HMRC will make contact.

When it comes to the MSC legislation, accountants should be proactive on not one, but two fronts:

- Communicate with contractor clients – not only to reassure them that your practice is taking this threat seriously but also to make sure that all parties are joined-up in their thinking if HMRC opens an enquiry. Ultimately, when looking to shut down a tax enquiry – regardless of whether it's MSC or IR35 – you need everyone singing off the same hymn sheet.
- Minimise the risk of being seen to be an MSCP – key to this is reducing the 'involvement' you have with the running of the contractor's company. In short, the more heavily involved an accountant is with the company in question the more likely an accountant is to be labelled an MSCP.

How to show limited involvement

With this in mind, here are a few pointers that will help you demonstrate that involvement is limited to providing accounting services only:

- The fees charged by the accountant mustn't correlate to the performance of the contractor's business. In an ideal world, you should avoid one size fits all packages. Instead, services should be tailored to the contractor.
- Accountants can, of course, recommend ways to maximise tax efficiency for their clients, but with regards to determining how a contractor pays themselves, it should be up to them, not you. The fact that the contractor has decided how to withdraw money from their business should be clearly documented, too.
- Don't get involved with contractors' agencies and or the business engaging them. Keep a safe distance from commercial contracts, whether IR35 or otherwise. Third parties can be engaged to advise on these matters, but accountants shouldn't have a say.
- Having access to a contractor's business bank account is another red flag. The contractor must also remain responsible for making all tax payments – in other words, don't do this on the contractor's behalf as part of your service.

MSC complexity calls for expertise

Like IR35, the MSC rules are notoriously complex. However, the MSC legislation is different to IR35 in the sense that the tax liability has the potential to be far greater.

Should HMRC find that a contractor has been operating via an MSC, all income generated by the MSC for the past six years could be subject to PAYE tax – in contrast, IR35 tends to focus on one or multiple contracts held between a contractor and their client.

Given determining if the MSC legislation applies is rarely black and white and that the tax liability can be staggering, engaging specialist advice could make the difference in protecting contractors, keeping them as your client and safeguarding your own financial interests overall.

What next?

Looking ahead, I wouldn't be surprised if HMRC ramps up its MSC compliance activity. In fact, I suspect this will be the case. The tax office is, after all, under enormous pressure to raise tax receipts and as we all know, has no hesitation in targeting contractors and the labour supply chain.

For the time being – and focusing on the two ongoing enquiries detailed in this article – we are aware that many of the contractors who have been contacted by HMRC (whom Qdos is supporting), along with the contractor accountants in question, are challenging the tax office's interpretation of the MSC rules.

This means it may be some time before a verdict is reached – and even that might even be appealed. Should HMRC win, the tax office may gain the confidence to launch more enquiries, which is a possibility that accountants need to be acutely aware of.

As always, we'll keep you updated as the situation unfolds.

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