

# Tax Representation



## TAXREP 29/08

### ‘SERVICE COMPANIES’ IN 2008 FORM P35, QUESTION 6

*Text of a letter sent on 15 April 2008 by the Tax Faculty of The Institute of Chartered Accountants in England and Wales to HMRC in response to an invitation dated 14 April 2008 to comment on draft supplementary guidance*

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## **‘SERVICE COMPANIES’ IN 2008 FORM P35, QUESTION 6**

### **FOREWORD**

Question 6 on HMRC employer end-of-year form P35 for 2008 asks:

- ‘Are you are a Service Company?’  
and then:
- ‘If “yes”, have you operated the Intermediaries legislation (sometimes known as IR35) or the Managed Service Companies legislation?’.

As the meaning of ‘Service Company’ is not readily apparent from HMRC’s guidance in booklet CWG2 (to which P35 refers) or Helpbook E10, we have been in communication with HMRC with a view to obtaining definitive guidance for employers as to what HMRC mean by ‘Service Company’ for the purpose of this question. We sent a note on 4 April 2008 to HMRC seeking clarification of whether they agreed our interpretation based on their guidance (see Annex B to the letter) in the hope that it would be resolved in a telephone conference on 10 April. It was not, but on 14 April HMRC sent us draft supplementary guidance with an invitation to comment. Our response submitted on 15 April is reproduced below.

Details about the Institute of Chartered Accountants in England and Wales and the Tax Faculty are set out in Appendix A. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex A to the letter.

PCB  
15.4.08

## SERVICE COMPANIES: 2008 FORM P35, QUESTION 6

### TEXT OF LETTER TO HMRC

I thank you for your invitation of yesterday inviting us to comment by the end of yesterday on draft supplementary guidance on form P35, Question 6. I trust that you received my holding reply sent yesterday at 17.59hrs, in which we recommended that you do not publish the supplementary draft guidance. We regret that we were unable to reply in full within your tight deadline.

Question 6 asks first: 'Are you are a Service Company?' and then: 'If "yes", have you operated the Intermediaries legislation (sometimes known as IR35) or the Managed Service Companies legislation?'

We remain unable to discern definitively from the proposed supplementary guidance what HMRC means by 'Service Company' in the first part of Question 6. It is unclear from the wording whether HMRC wants to identify those businesses that do nothing but supply the services of individuals to perform work for their customers, whether or not they fall within the IR35 and MSC rules in Chapters 8 or 9 respectively of ITEPA 2003, or whether HMRC wants to identify only those businesses that do fall within those IR35 and MSC rules.

One of the first of our Ten Tenets for a Better Tax System, which we use to benchmark tax measures (see Annex A), is 'certainty'. Neither CWG2, nor E10, nor the draft supplementary guidance provide certainty as to what HMRC are asking for in Question 6.

In the light of the fact that:

- (a) despite the undertaking in paragraph 4.27 of the consultation document *'Tackling Managed Service Companies'* published at PBR 2006 on 6 December 2006 which said that the question 'Are you a service company?' would be accompanied by 'a clear definition of "service company" to enable a judgment to be made readily,' it is impossible to discern what HMRC means by 'Service Company' from the guidance already in the public domain, therefore no-one completing the forms P35 knows with certainty what the questions mean, and the draft supplementary guidance does not help dispel the confusion;
- (b) we are now well within the period in which employers are filing their end-of-year returns P35 and many employers have already filed (we understand approximately 200,000 P35s had been filed by last Friday, covering approximately 1 million forms P14) and many more P35s are likely to have been filed before HMRC publishes adequate guidance; and
- (c) those who have already filed should not be obliged to amend their returns in the light of subsequent guidance and those who have not yet filed, possibly only because they are waiting for guidance as to how to answer Question 6, should not be disadvantaged,

we:

- (a) recommend that you do not publish the supplementary draft guidance as it stands;

- (b) would welcome confirmation that HMRC will not use the answers to Question 6 this year and there will be no adverse consequences for those who respond however they answer the two parts of the question (for example, the replies will be ignored for risk profiling purposes); and
- (c) would welcome an undertaking that HMRC will consult in good time on the wording of both the questions and the guidance for next year (so that the wording of next year's questions and guidance reflect whatever it is HMRC wants to know).

In addition, we consider that HMRC should, as a matter of urgency, send an appropriate communication to all employers and post a message on What's New saying:

- sorry for the confusion;
- that HMRC will not use the answers to the questions this year and there will be no adverse consequences for those who respond, however they answer them; and
- that for next year HMRC will consult employer representatives in good time on the wording of both the questions and the guidance.

In the absence of comment at the MPPC telephone conference on 10 April, we would also welcome clarification of whether you agree with the conclusions that we drew in our paper sent on 4 April ...to [you] (Annex B), and specifically, does HMRC expect all companies providing services (as opposed to selling goods) to answer 'Yes' to the first part of Question 6 and 'No' to the second part unless the company is caught by IR35 or MSC legislation? Or, as we conclude in our paper, the question is concerned only with those companies caught by IR35 or MSC rules who should be applying those rules.

Similar undertakings and communications are needed in respect of the 'Service Company' questions on the ITSA tax return. We look forward to your response to the other questions raised in our [other] letter to [you].

## THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see <http://www.icaew.co.uk/index.cfm?route=128518>.

**TAX FACULTY DRAFT SENT TO HMRC ON 4 APRIL 2008**

**How do I reply to Question 6 on service companies in employer end-of-year form P35?**

Concern has been expressed about Question 6 on HMRC employer end-of-year form P35 which asks first: 'Are you are a Service Company?' and then: 'If "yes", have you operated the Intermediaries legislation (sometimes known as IR35) or the Managed Service Companies legislation?'.

Form P35 directs the reader to HMRC book CWG2 *Employer Further Guide to PAYE and NICs* for more detailed information. No cross reference is provided to where in CWG2 the more detailed information can be found, but the most logical place is the final section of Chapter 4 called '*Payments made to an Individual Worker through a Service Company or Partnership*'.

Despite the undertaking in paragraph 4.27 of the consultation document '*Tackling Managed Service Companies*' published at PBR 2006 on 6 December 2006 which said that the question 'Are you a service company?' would be accompanied by 'a clear definition of "service company" to enable a judgment to be made readily,' the aforementioned explanation in CWG2 for 2008 jumps straight into descriptions of the IR35 and managed service company legislation. Whilst it would have been helpful to have an explicit definition of service company as promised in the condoc, jumping straight to descriptions of IR35 and managed service companies indicates to us that the meaning of service company must be interpreted in this context. Incidentally, CWG2 for 2008 is not readily available on HMRC's website – their search engine directs you to that for 2007.

Guidance in HMRC Booklet E10: *Finishing the tax year up to 5 April 2008* (<http://www.hmrc.gov.uk/helpsheets/e10.pdf>) at page 18 explains more clearly what HMRC consider is a service company. Again, it does this in the context of engagements affected by the IR35 rules and workers providing their services through managed service companies.

We interpret both sets of guidance as meaning that unless you are a personal service company or managed service company within the terms of Chapters 8 or 9 of Part 2, ITEPA 2003, then you should reply 'no' to the first question.

Furthermore, if you have answered 'no' to the first question, then the answer to the second must also be 'no'. If, on the other hand, you are applying the IR35 intermediaries legislation or running managed service companies then you are likely to be able to work out quite easily that you should answer 'yes' to both questions.

### ICAEW AND THE TAX FACULTY: WHO WE ARE

1. The Institute of Chartered Accountants in England and Wales (ICAEW) is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
2. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department for Business, Enterprise and Regulatory Reform through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
3. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter *TAXline* to more than 10,000 members of the ICAEW who pay an additional subscription.
4. To find out more about the Tax Faculty and ICAEW including how to become a member, please call us on 020 7920 8646 or email us at [taxfac@icaew.com](mailto:taxfac@icaew.com) or write to us at Chartered Accountants' Hall, PO Box 433, Moo rgate Place, London EC2P 2BJ.