



Jonathan Mann's "QUICK GUIDE" to PERSONAL SERVICE COMPANIES

With all the news and hype in the press about "personal service companies", this is a simplified, unbiased guide to what all the fuss is about.

WHAT IS A PERSONAL SERVICE COMPANY ?

It is a normal UK private company owned and used by an individual to provide his professional services to someone else. The individual is a shareholder of the company, a director of it, and an employee. It is no more complex than that.

FACTS ABOUT PERSONAL SERVICE COMPANIES ?

FACT 1: Personal service companies are a quite valid and legal means of carrying out business activity in the UK. Anyone carrying on a business in the UK can validly use a limited company to do so.

FACT 2: There may be some tax and national insurance savings to be made by using a personal service company when compared to being taxed as an employee. However note that there may be some disadvantages — lack of sick pay or holiday pay and no employment protection.

FACT 3: Personal service companies are commonly used by individuals running their own business as a means of carrying out their trade or profession.

WHAT IS THE BENEFIT OF USING ONE OF THESE COMPANIES ?

The benefit is that there can be a tax savings compared to being an employee. Why?

A personal service company gives an individual the flexibility to remunerate himself or herself using several different options. The company will charge the "customer" for the individual's services. The individual can then choose how to take earnings from their company using any or all of: a) a salary, b) a dividend or c) in more complex cases, a loan. This flexibility can be used to lower the amount of tax paid by the individual below the amount payable if they were to be a direct employee of their customer.

- As an employee, an individual will pay income tax (20% to 50%) plus National Insurance (2% to 12%). The employer also pays National Insurance contributions.
- If trading via a personal service company, the individual will suffer a) corporation tax on the company's profit (normally 20%), plus income tax on the dividend (as low as 0% or as high as 32.5%), plus any PAYE and NI paid on a salary from the company.

The total amount of tax payable is frequently lower when using a personal service company, if it is carefully structured, and in particular where use is made of dividends.

WHAT IS THE ISSUE ?

The use of a personal service company by say a plumber, or a financial adviser is a perfectly reasonable thing to do. There is no issue with this. They will be "self-employed", have many customers over a year, and will want or need a separate legal entity from which they can carry on their trade.

However, HM Revenue and Customs take issue where a personal service company is used by someone who is, in reality, an employee. For example, if a personal service company has only one full-time customer all year, HMRC may claim that customer is in reality the "employer" of the person who owns the company. The HMRC will then claim that the only purpose of the company is to save tax and demand payment of tax they have lost.

HM Revenue and Customs use "IR35" to attack individuals using personal service companies in this way.

SO THE REAL ISSUE IS "ARE YOU EMPLOYED OR SELF-EMPLOYED" ?

Correct.

The tax authorities take the view that whether an individual is employed or self-employed is a matter of fact, not choice. This "fact" is based on the nature of the relationship between an individual and his customer/employer. For example:

- An employee will have pension rights, sick pay, entitlement to redundancy etc.
- A personal service company will have a contract with its customer that is a corporate relationship and does not give the same employee-type rights and entitlements to an individual.

In very simple terms if the nature of your work means you are "self-employed", there is no issue. If the nature of your work is that you are "an employee", you are at risk if you use a personal service company.

For some people it is clear whether they are employed or self-employed. For others the situation may be quite "grey". Various tests are used to determine the status.

WHAT IS THE ISSUE AT THE BBC ?

The reported outrage is that the BBC, an organisation funded by taxpayers, allows "employees" to save tax by letting them operate through personal service companies.

Note that the BBC does validly employ myriads of self-employed craftsmen and it would seem fine for them to use personal service companies to work with the BBC. However, it is suggested that permanent employees should not do so. Consider the difference between a) a full-time newsreader, and b) a very specialist cameraman who works at the BBC for one day and the next day works for Sky. Their status is quite different.



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