

## The “Yes”/ “No” Dilemma – Service Company Questions on the P35 and Tax Return

The topic of the service company questions that were introduced on the 2007-08 P35 and self assessment returns continues to be a hot topic. HMRC did acknowledge last year that their initial guidance had been inadequate and that the information on any 2007-08 returns submitted prior to their revised guidance being issued (in September 2008) would not be used to select businesses for IR35 enquiries. There are no such guarantees for any 2008-09 returns so it is important for freelancers/contractors (and their accountants) to take advice on their position - especially as penalties can now be levied where an individual has been negligent by not taking advice.

Although completing tax returns is now the priority, the logical starting point for looking at this issue is still the P35.

### P35 - Question 6 on Page 4

There are two parts to this question: the first asks if you are a "service company". If you answer 'yes', then the second part asks whether you have applied the IR35 or Managed Service Company (MSC) legislation.

This year, HMRC have included guidance on page 18 of their employers booklet E10 - see <http://www.hmrc.gov.uk/helpsheets/e10.pdf>. The guidance is similar to the tax return guidance that was published by HMRC in September 2008.

It is important to note the definition of the term "service company". It should not be interpreted as *"is your company a personal service company caught by IR35?"* Instead it should be read as ***"does your company provide services (as opposed to physical goods) and does most of its income come from work the shareholders have done personally?"***

In our experience, most contractors operating via their own limited companies should tick 'Yes' to the first part because the shareholders are usually also the main fee earners of the business. We would stress that answering 'Yes' to the first part of the question is **NOT** an admission that the contractors is providing *personal service* on a particular engagement. Turning to the second part of the question: this is very straightforward. If the client believes their engagements are not caught by IR35 and is not operating an MSC, then the answer here will be "No".

### Tax Return

The service company question is found at the bottom of page TR4 with the guidance in the accompanying notes on P19 – <http://www.hmrc.gov.uk/worksheets/sa150.pdf>. The guidance is largely unchanged from the 2007-08 revised guidance. If you can answer "Yes" to all three tests, the amount of gross dividends and salary the individual has received from their company need to be entered onto the tax return.

As a final thought, the issues outlined above will not be restricted to contractors and freelancers – it could indeed equally apply to any small professional firm operating through a limited company...

If you would like to discuss these issues, or would like to ensure that your clients undertake due diligence to avoid unnecessary penalties by having their engagements reviewed in relation to IR35, then please contact Paul Mason from our Contractor Division on **0870 607 7000** or please e-mail [contractreviews@abbeytax.co.uk](mailto:contractreviews@abbeytax.co.uk) quoting reference **CR09**.