



Blake Laphorn Tarlo Lyons'
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"offshore" arrangements for contractors: should you be worried?

A year on from the introduction of the controversial Managed Service Company (MSC) legislation, employment businesses and service providers to the recruitment sector are still working out how best to avoid arrangements that could lead to debt transfer. With the "composite" option gone, many contractors have had to choose between relatively less tax efficient umbrella-type solutions and setting up and running their own limited personal service company (PSC). Many employment businesses have become increasingly careful about referring contractors to umbrella providers (some of whom may not be as legitimate as others) and have adopted the policy of asking these providers to complete checklists before they are prepared to refer contractors to them.

A number of recruiters have been approached by what appear to be professionally run and legally compliant offshore arrangements offering to "employ" contractors and to pay them on a tax efficient basis. We think that an apparent increase in this type of structure is a direct result of the MSC legislation. These arrangements come in a variety of different guises and almost all those that we have come across claim leading tax counsel's approval of their scheme. We have seen partnership structures with payments into employee benefit trusts, "dual umbrella" structures, direct employment with payment in the form of loans, foreign exchange contract arrangements and so on. Some arrangements are more transparent than others and are backed up by tax counsel's opinion. What is often less obvious is that in some cases offshore arrangements "sit behind" what appears to be a UK registered and resident umbrella company. In assuming that all umbrella companies are "safe" from a MSC risk point of view, some employment businesses have later found out that they have been misled into dealing with the UK front to an undisclosed offshore arrangement. For this reason we have consistently advised recruiters to check that the UK umbrella (and not a third party) pays the contractor direct.

why should contracting with an offshore arrangement (or an umbrella fronting such an arrangement) pose a risk to recruiters?

Perhaps the risk recruiters are most worried about is debt transfer under the MSC legislation. Although HMRC has gone to some lengths to reassure recruiters that in most cases they will not pursue an employment

business unless there is strong evidence that it has encouraged and been actively involved in the MSC, the risk of debt transfer increases significantly where the MSC is based offshore. HMRC's guidance makes it very clear that the fact that a managed service company or managed service company provider is based offshore does not mean that the MSC legislation does not apply. Indeed HMRC has confirmed on several occasions that where an employment business is dealing with an offshore MSC or MSC provider, the risk of debt transfer increases significantly. For employment businesses, the practical effect of this is that if it deals with an offshore arrangement it may face debt transfer risk in a situation where had it dealt with a solely UK-based provider it would not have been so affected.

Obviously debt transfer under the MSC legislation will be an issue only if the MSC legislation applies to the offshore arrangements being offered. Some argue that because they are "employment" solutions and all the income is classed as employment earnings the MSC legislation does not apply. Whether or not the MSC legislation applies often boils down to very technical analysis of the structures in place and the interplay between the different companies or partnerships in the supply chain. Legal opinions made available by these providers appearing to justify these schemes cannot and should not be relied upon as a basis for deciding whether or not to refer contractors to these organisations. Remember that legal opinions are often given on the basis of limited instructions and can form part of an overall much larger set of tax compliance issues. Remember also that you will not be able to sue someone else's lawyer if their opinion is wrong. Essentially, it remains very difficult to know for sure

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whether an offshore arrangement falls within the scope of the MSC legislation because you can never be sure that you have all the facts.

Often offshore solutions claiming that they are not caught by the MSC legislation have sought to agree referral fee arrangements, management fee reduction or "kick backs" as part of the deal so that the employment business is incentivised to refer as many contractors to them as possible. We have heard anecdotal evidence that some large employment businesses are referring large numbers of contractors to these arrangements. Even in the absence of debt transfer (of which you can rarely be certain in the first place) we would strongly advise employment businesses not to accept or agree referral arrangements of any kind. As we have always advised, acceptance of referral fees (or similar) is far more likely to "involve" an employment business in the supplying company and therefore far more likely trigger either direct MSC liability as MSC provider or under the debt transfer provisions.

Even if you can establish that the MSC legislation does not apply, recruiters still need to be on their guard against referring to inappropriate payment arrangements. Tax efficient payment schemes are more likely to receive scrutiny from HMRC and could result in substantial personal tax liabilities for individual contractors. This is seldom something contractors seek or are even advised to take specialist tax advice on. Whilst, in the absence of debt transfer, tax assessments against the offshore companies (etc) are highly unlikely to transfer to employment businesses, tax assessments against contractors could lead to damaging adverse publicity for the employment business.

The Government announced in its latest Budget that it is to introduce measures to tackle avoidance schemes that make use of the UK Double Taxation Agreement (DTA) to avoid UK tax. We have seen a number of such structures that are attractive to contractors because they effectively reduce offshore partnership and personal tax liabilities to zero. Such schemes involve artificially diverting income of a UK resident individual to a foreign partnership comprising foreign trustees and claiming that the provisions of the UK's DTAs exempt the partnership profits from UK tax, not only in the hands of

the foreign partners but also for the UK beneficiaries. Once introduced into legislation it is thought that HMRC will have power to retrospectively assess offshore partnership arrangements as far back as 1987. This could lead to legal battles and tax assessments for a number of contractors and not all of them working on higher paid higher skilled assignments.

We believe that HMRC will start taking action in the next few months relating to offshore arrangements and referrals into them.

what can recruiters do to minimise the risk of dealing with offshore arrangements?

HMRC has confirmed it accepts that employment businesses may want to put together preferred supplier lists of umbrella service providers. If a recruiter decides to do this we would strongly recommend that it asks the umbrella provider to complete and return a checklist designed to confirm the following:

- That the umbrella is registered and operates from the UK.
- It engages contractors directly and not via a third party.
- It pays 100% of all income due to the contractor directly to the contractor and not via any third party.
- It does not make any onward payments of any monies due to the contractor to a third party.
- To provide examples of payslips showing the deductions made and payments to the contractor.

If approached with a proposal to "divert" a substantial volume of contract or temporary workers via a third party, you should request legal details of the arrangement and get them checked out with your lawyers before proceeding. Be especially careful about agreeing to any referral arrangements that involve incentive payments (whatever form they may take) and question closely any organisation which offers a "solution" without first enquiring about the nature and status of the work the contractors do.

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