HMRC - VATSC96400 - Direction Of Supplies: The VAT Position Under The IR35 Rules For Personal Service Companies

Intermediaries such as service companies can be set up to provide the services of a single worker to a client, where the worker would be an employee of the client if it were not for the service company. The use of service companies in this way allows the client to make payments to the company rather than the individual without deducting PAYE or NICs. The worker then takes the money from the service company in the form of dividends rather than salary, again avoiding NICs.

In order to counter such avoidance, the Inland Revenue introduced the IR35 rules (named after the 1999 Budget news release numbered IR35). Under these rules, the service company is treated as making a payment to the worker chargeable to income tax under Schedule E plus NICs. This applies when HMRC is satisfied the worker would have been an employee of the client had it not been for the existence of the service company.

Even though income is attributed to the worker under the rules, the service company’s VAT position is unaffected. This is because it is the company and not the worker who has the contract to provide services to the client and so it is required to account for VAT in the normal way.

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