

In the matter of Contrella Limited

INSTRUCTIONS TO COUNSEL TO ADVISE

Introduction

1. Counsel is instructed to advise Contrella Limited ('Contrella') which is an intermediary contracting business specialising in the provision of contracting services to temporary work agencies across the UK.
2. The head office is at The Coach House, Clarence Road, Wolverhampton, WV1 4JH.
3. The following copy documents are enclosed with these instructions:
 1. Terms of Business (Contrella to Agency)
 2. Terms of Business (Contrella to End User)
 3. Contract for Services (Specialist Contracting Intermediary ('SCI') to Contrella)
 4. Contract of Employment SCI to Worker (No Expenses, 0 hours)
 5. Contract of Employment SCI to Worker (Reg 10, No Expenses, 0 hours, PBA)
 6. Service Contract for Services of SCI Directors to SCI
 7. Contract for Services SCI to Accountable Accounting (AA) for Accountancy Services
 8. Referral Fee Agreement Compass Star to SCI

Background

1. Contrella is an intermediary contracting business. In the main, operatives engaged by Contrella are paid at or around the National Minimum Wage ('NMW').
2. HMRC announced in the Autumn Statement and confirmed in the Finance Bill 2016 that it intends to restrict the relief available on travel expenses for workers who provide a personal service to a client, through an employment intermediary where Supervision Direction or Control (or right of) exists. In this regard, Counsel's attention is drawn to the recent consultation documents concerning travel and subsistence ("Employment Intermediaries and Tax Relief for Travel and Subsistence") and Clause 9 of the Finance Bill 2016.

3. These changes, along with the introduction of the National Living Wage ('NLW') and general increase in operating costs caused by pressures on the contracting market means that Contrella is looking to outsource its labour supply to small specialist contracting intermediaries ('SCI') who will be able provide the services to Contrella at a commercial and competitive price. This will enable Contrella to have a have a viable business from April 2016.
4. The SCI can charge a competitive price to Contrella as they can take advantage of lower operating costs and reliefs available to small businesses, such as the Flat Rate VAT scheme ('FRV') and the Employment Allowance ('EA').
5. Contrella consider that there are sound commercial and operational reasons for the proposed structure and in this regard would like to seek Counsel's opinion on the viability of such a contracting arrangement as well as ensuring that the proposed contractual documents are fit for purpose.

Overview of operating Procedures

6. As highlighted above, the proposed outsourcing structure is based on the principle that, instead of employing all workers under one legal entity, the workers will be employed via a series of SCI companies. Although the primary purpose of the structure is to mitigate the increase in costs that have arisen from the removal of relief on travel expenses, there are commercial benefits throughout the supply chain.
7. Candidates apply to vacancies advertised by Contrella's agency clients ('Agencies'). These agencies assess their suitability and explain to the successful candidates that they do not contract for their services directly due to a number of operational reasons. These workers are then referred to Contrella.
8. Contrella will enter into terms of business with its agencies for the provision of specified services. The terms allow Contrella to subcontract the work in order to complete the services set out within the contract.
9. Contrella agree a commercial rate for the services of the candidate and will then speak to the candidate to ascertain their desired pay rate. Where the desired rate means the supply would not make commercial sense, Contrella inform the candidate that they cannot engage them directly and refer them to a SCI that specialises in the candidates' sector.

10. The SCIs are introduced to Contrella by Compass Star. Compass Star is a business registered in the British Virgin Islands. Compass Star is not connected to Contrella, AA, or to any SCI's. More details on Compass Star can be found at <http://compassstarltd.com/>. Compass Star helps individuals set up businesses within the UK Contracting market by introducing them to potential customers.
11. Contrella will enter in terms of business with the most appropriate SCIs. Contrella and the SCIs will be independent from each other and will not share any common directors or shareholders or management.
12. It is envisaged that each SCI will employ, on average, four workers. Each SCI will aim to utilise the £2,000 Employment Allowance (£3,000 from April 2016) in respect of Class 1 Secondary National Insurance due on the employment income of the workers.
13. These workers will be engaged, in the main, on Zero Hour Contracts of Employment by their chosen SCI. Workers will receive at least the National Minimum Wage (or National Living Wage where appropriate) and all pay will be treated as Employment Income (as per section 7(2) ITEPA 2003).
14. Each SCI will be formed by AA. AA is a UK limited company and is not "connected" by virtue of common directors or shareholders with either Contrella or the SCIs. AA provides accountancy services and will incorporate the SCIs using nominee directors and shareholders and make an application to HM Revenue and Customs ('HMRC') as agent of the SCI for FRV, PAYE, Corporation Tax and Construction Industry Scheme (CIS) where appropriate.
15. The FRV which will be applied for will depend on the type of services being delivered by each SCI. Each SCI will reduce its flat rate by 1% until the day before the first anniversary of becoming VAT registered.
16. Once formed, each SCI will be offered for sale to an unconnected party who is likely to be an overseas resident ('purchaser'). They will become the sole director and shareholder of the SCI. AA will find these prospective purchasers from introductions made by Compass Star.
17. The purchaser will sign a Director Service Agreement with the SCI and be entitled under this contract to receive remuneration from the SCI. The SCI will pay for its own costs such as staff and insurance. Any company profits will be subject to UK Corporation Tax. Each director/shareholder will be responsible for his/her own professional fees in relation to their own tax affairs.

18. Compass Star will introduce the SCI to potential customers under an introducer's agreement. Where a successful introduction is made, Compass Star will be entitled to receive a referral fee which will not be subject to VAT due to its geographical location.
19. It is envisaged that AA, will act as agent for the SCIs once they have been sold to the purchaser. They will also provide other back office services to the SCI, including, Human Resources advice, accounting and payroll services. They will also operate a client account for SCIs into which payments from Contrella will be held prior to distribution to the SCIs workers and suppliers.
20. The services that AA supplies to the SCI will be covered under a Service Agreement for which it will charge a fee plus VAT.

Appropriate Legislation

Employment Allowance and Employers National Insurance

21. Each SCI will utilise the Employment Allowance (EA) in respect of Class 1 Secondary National Insurance due on the employment income of workers.
22. Provision for the NIC EA is made by the National Insurance Contributions Act 2014 which states at section 1(1):
- (1) A person qualifies for an employment allowance for a tax year if, in the tax year—*
- (a) the person is the secondary contributor in relation to payments of earnings to, or for the benefit of, one or more employed earners, and*
- (b) in consequence, the person incurs liabilities to pay secondary Class 1 contributions, under SSCBA 1992 or SSCB(NI)A 1992 (or both).*
23. We are aware that HMRC intend to amend the National Insurance Contributions Act 2014, effective April 2016, to increase the EA to £3,000 and to restrict the allowance for Limited Companies where the payments of earnings are paid to the same employed earner and the employed earner is a director. We do not think this will affect the SCIs as they will contain more than one employed earner.
24. Earnings are defined in the Social Security Contributions and Benefits Act 1992 (SSCBA 1992):

Section 3 (1) states:

- (a) "earnings" includes any remuneration or profit derived from employment; and*
- (b) "earner" shall be construed accordingly.*

25. Section 6 of SSCBA 1992 says who is liable for secondary class 1 NIC contributions in 4(b):

Section 6 requires that:

(4) The primary and secondary Class 1 contributions referred to in subsection (1) above are payable as follows—

(b) the secondary contribution shall be the liability of the secondary contributor

(1) Where in any tax week earnings are paid to or for the benefit of an earner over the age of 16 in respect of any one employment of his which is employed earner's employment—

(b) a secondary Class 1 contribution shall be payable in accordance with this section and section 9 below if the amount paid exceeds the current secondary threshold (or the prescribed equivalent).

26. Section 7 of SSCBA 1992 states that;

For the purposes of this Act, the "secondary contributor" in relation to any payment of earnings to or for the benefit of an employed earner, is

(a) in the case of an earner employed under a contract of service, his employer

27. In addition, HMRC's guidance at NIM33710 supports this by stating:

The secondary contributor is the person under the Social Security Acts responsible for, amongst other things paying the secondary National Insurance Contributions (NICs); and deducting primary NICs from the employee. The secondary contributor is usually the contractual employer where the employee is employed under a contract of service.

28. Based on the above legislation, our view is that, it will be the SCI as the secondary contributor (the employer), who uses the EA, that will be liable if EA is utilised and it is subsequently found to be ineligible.

29. Section 121C of the Social Security Administration Act 1992 deals with the transfer of a company's NIC debt to an officer of that company via the use of a Personal Liability Notice when

the company has failed to settle its debt. This can only be done when the debt is attributable to fraud or negligence on the part of the officer(s) at the time when the debt arose.

121C

- 1) *This section applies to contributions which a body corporate is liable Liability to pay, where—*
 - a) *the body corporate has failed to pay the contributions at or within the time prescribed for the purpose; and*
 - b) *the failure appears to the [Inland Revenue] to be attributable to fraud or neglect on the part of one or more individuals who, at the time of the fraud or neglect, were officers of the body corporate (“culpable officers”).*
- 2) *The [Inland Revenue] may issue and serve on any culpable officer a notice (a “personal liability notice”)—*
 - a) *specifying the amount of the contributions to which this section applies (“the specified amount”);*
 - b) *requiring the officer to pay to the [Inland Revenue]—*
 - i) *a specified sum in respect of that amount; and*
 - ii) *specified interest on that sum; and*
 - c) *where that sum is given by paragraph (b) of subsection (3) below, specifying the proportion applied by the [Inland Revenue] for the purposes of that paragraph.*
- 3) *The sum specified in the personal liability notice under subsection (2)(b)(i) above shall be—*
 - a) *in a case where there is, in the opinion of the [Inland Revenue], no other culpable officer, the whole of the specified amount; and*
 - b) *in any other case, such proportion of the specified amount as, in the opinion of the [Inland Revenue], the officer’s culpability for the failure to pay that amount bears to that of all the culpable officers taken together.*
- 4) *In assessing an officer’s culpability for the purposes of subsection (3)(b) above,*
the [Inland Revenue] may have regard both to the gravity of the officer’s fraud or neglect and to the consequences of it.
- 9) *In this section—*
“officer”, in relation to a body corporate, means—
 - (a) *any director, manager, secretary or other similar officer of the body corporate, or any person purporting to act as such;*

30. Fraud and neglect are not defined in legislation. However, HMRC's guidance NIM12209 give us useful information in relation to them:

HMRC's NIM12209 states:

"For a Personal Liability Notice to be issued there must be evidence to show 'on the balance of probabilities' that the failure to pay the contributions due was attributable to the fraud or neglect of an individual officer of the company".

"Negligence is the omission to do something which a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not do. The defendants might be liable for negligence, if, unintentionally, they omitted to do that which a reasonable person would have done, or did that which a person taking reasonable precautions would not have done."

"For HMRC purposes, it will generally constitute falsification with intent to deceive. The active intent to deceive may be so slight that the falsification differs little from that resulting from negligence. On the other hand, the falsification may be deliberately planned with the clear intention of deception by, for example, the omission, manipulation or invention of figures or other records"

31. Our view is that HMRC would transfer the liability to the director of the company if they deemed the EA was not allowable.
32. A person cannot qualify for an EA for a tax year if, the person would qualify in consequence of avoidance arrangements. Subsection 10 to 13 of Section 2 NIC Act 2014 sets out the Anti Avoidance Provisions;

Anti-avoidance

(10) A person cannot qualify for an employment allowance for a tax year if, apart from this subsection, the person would qualify in consequence of avoidance arrangements.

(11) In a case not covered by subsection (10), liabilities to pay secondary Class 1 contributions incurred by a person ('P') in a tax year are "excluded liabilities" if they are incurred by P, or are

incurred by P in that tax year (as opposed to another tax year), in consequence of avoidance arrangements.

(12) In subsections (10) and (11) “avoidance arrangements” means arrangements the main purpose, or one of the main purposes, of which is to secure that a person benefits, or benefits further, from the application of the employment allowance provisions.

(13) In subsection (12) “arrangements” includes any agreement, understanding, scheme, transaction or series of transactions (whether or not legally enforceable).

33. Our view is that Contrella’s commercial decision to outsource the supply of workers is not caught by the anti-avoidance provisions as the main purpose, or one of the main purposes, is not to benefit from the EA. The main purpose is to reduce the operating costs of Contrella and to mitigate risk associated with employing the individuals. In this regard, Counsel is drawn to Spotlight 24 issued on 25th June 2015 and in particular, the reference to the Disclosure of Tax Avoidance Schemes (DOTAS) rules.

34. Section 3 in the NIC Act 2014 sets out connected companies. The purpose of section 3 is to ensure that two or more connected companies only receive one EA. The meaning of ‘connected’ is set out in Schedule 1 Part 1 of NIC Act 2014.

35. ‘Connected’ means either;

(a) one of the two has control of the other, or

(b) both are under the control of the same person or persons.

36. Control has the same meaning as sections 450 & 451 Company Taxes Act (‘CTA’) 2010. Broadly, control of another company exists where a person has the right to exercise or is entitled to acquire control over a company. The legislation focuses in particular on a person being entitled to acquire the share capital and voting power of the company.

37. Consideration also needs to be given to section 3 in part 1 of Schedule 1 NIC Act 2014 regarding ‘substantial commercial interdependence’. In determining ‘substantial commercial interdependence’, the following factors need to be considered;

1) financially interdependent

i. one gives financial support (directly or indirectly) to the other

- ii. each has (directly or indirectly) a financial interest in the other's activities.
- 2) economically interdependent
 - i. they seek to realise the same economic objective,
 - ii. the activities of one benefit the other, or
 - iii. their activities involve common customers.
- 3) organisationally interdependent
 - i. common management,
 - ii. common employees,
 - iii. common premises, or
 - iv. common equipment.

38. Our view is that there is;

- 1) No financial link between any of the companies within the supply chain (there is no financial support or interest in each of the others' businesses),
- 2) No economic link between any of the companies within the supply chain (whilst the activities of one may benefit another and common customers, may exist, this is no more than a commercial relationship in which, when a customer grows, it is likely to increase the demand from its suppliers).
- 3) No organisational link between any of the companies within the supply chain (whilst they may share a registered office, the management, employees, equipment and where the services are provided are all different)

Flat Rate VAT

39. The legislation relevant to the application of the Flat Rate VAT Scheme is contained within section 55A to 55V, 57A and 69A of the VAT Regulations 1995.

40. The Scheme is designed to reduce administrative burden for small businesses by reducing work in recording VAT sales and purchases. Whilst they continue to charge VAT at the full rate they are allowed to pay VAT on a set percentage relevant to the industry/sector that they work in.

41. To qualify there must be reasonable grounds for believing that the value of taxable supplies to be made by the business within the period of one year will not exceed £150,000 and they are not, and have not been within the past 24 months, associated with another person.

42. Regulation 55M(1), VAT Regulations 1995, gives;

that a company registered for FRV is no longer eligible to use the scheme where –

(f) They become –

(iii) associated with another person.

43. Associated is defined in Regulation 55(A) as follows:

(2) For the purposes of this Part, a person is associated with another person at any time if that other person makes supplies in the course or furtherance of a business carried on by him, and—

(a) the business of one is under the dominant influence of the other, or

(b) the persons are closely bound to one another by financial, economic and organisational links.

44. Whilst these are not defined within the VAT legislation, HMRC has issued its views via VAT Notice 733 which describe the test as a 'commercial reality'. HMRC published guidance further refers to the 'commercial reality' meaning that one business has the right to give directions to another or in practice, a business habitually complies with the direction of another. A close connection is not necessarily the same as being associated. For example, a business is not associated with its customers just because it supplies them with the goods (or services) they request in the form they request them.

45. Our view is that whilst the businesses have close connections there is a normal commercial relationship in place between the parties and any influence will only be because of the bargaining power of the customers.

46. There are also provisions that can mean liability can be transferred to an individual in certain circumstances. Section 60 and sections 61 of the VAT Act 1994 allows for a "basic penalty" to be transferred to a director or managing officer of a company where the conduct giving rise to the penalty was down to fraud or dishonesty. Section 61(6) defines managing officer as;

61(6) - "In this section a "managing officer", in relation to a body corporate, means any manager, secretary or other similar officer of the body corporate or any person purporting to act in any such capacity or as a director; and where the affairs of a body corporate are managed by its members,

this section shall apply in relation to the conduct of a member in connection with his functions of management as if he were a director of the body corporate.”

47. HMRC states that it may withdraw the scheme at any time for the protection of the revenue and will specify the date of withdrawal in a notice of withdrawal. Additionally, if HMRC withdraws the scheme because the SCI was never eligible to use it, HMRC will backdate the withdrawal to the time when the company started to use the scheme and the company will have to account normally for VAT from this date.
48. To assist Counsel in understanding, we have supplied a diagram at Appendix I providing an overview of the supply chain.

Questions for Counsel to consider

49. **Based on the operation outlined above, does Counsel agree that the SCIs are unconnected for the purposes of the Employment Allowance?**
50. **If HMRC were to find that the SCIs were connected, who are they likely to say they are connected to? (for example, to another SCI or Contrella or AA)**
51. **In Counsel’s opinion, who would be liable for the Secondary National Insurance Contributions were a connection to be established?**
52. **Counsel is asked to consider the chance of success by HMRC in transferring the liability to a Director of that liable company.**
53. **Does Counsel agree that the contracting arrangement falls outside of the anti-avoidance provisions contained within the NIC Act 2014?**
54. **Counsel is asked to comment on any other means by which HMRC could deny the applicability of the Employment Allowance under the proposed structure?**
55. **Does Counsel agree that the SCIs will not be associated for the purpose of utilising the FRV arrangement?**
56. **If HMRC were to argue that the SCIs were associated, who are they likely to say they are associated to? (for example, to another SCI, Contrella or AA)**

57. In Counsels opinion, what chance of success have HMRC got in removing the FRV status and which entity would be liable?
58. Counsel is asked to consider the chance of success by HMRC in transferring the liability to a Director or Managing Officer?
59. Counsel is asked to comment on any other means whereby HMRC could deny the utilisation of FRV.
60. In general, Counsel is asked to comment upon the possibility of transfer of debt to the directors/shareholders of Contrella and AA in the event that liabilities were accrued in the SCIs and not discharged.
61. Does Counsel believe using a Nominee to incorporate the SCIs and to make FRV and PAYE applications to HMRC creates a connection, bearing in mind that the SCIs will be sold prior to trading?
62. In Counsel's opinion, could HMRC deny the FRV and PAYE applications because of the use of a Nominee?
63. Does Counsel agree that the proposed arrangement is unlikely to be found by a tax tribunal as an "avoidance arrangement"?
64. Does Counsel agree that this arrangement will not be caught by the Disclosure of Tax Avoidance Scheme (DOTAS) rules in the context of services offered by Contrella or AA?
65. Counsel is also asked to consider whether Contrella or AA could be considered to be a "promoter" of a tax avoidance scheme.
66. In Counsel's view, would HMRC have to challenge each SCI on a case by case basis?

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