

*These notes refer to the Income Tax (Earnings and Pensions)  
Act 2003 (c.1) which received Royal Assent on 6th March 2003*

# **INCOME TAX (EARNINGS AND PENSIONS) ACT 2003**

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## **EXPLANATORY NOTES**

### **COMMENTARY ON SECTIONS**

#### *Glossary*

#### **Part 2: Employment income: charge to tax**

#### *Chapter 8: Application of provisions to workers under arrangements made by intermediaries*

#### **Overview**

189. The provisions in this Chapter are commonly known as the “service company provisions”.
190. The material in this Chapter derives from Schedule 12 to FA 2000 and follows much the same order as that Schedule. References in the notes on this Chapter to paragraphs are all references to paragraphs of Schedule 12 to FA 2000 unless otherwise stated.
191. This Chapter does not include anything in respect of paragraphs 17 or 18, which concern the computation of profits of the intermediary and are to be dealt with in the rewrite of the trading income provisions.
192. This Chapter also excludes the material from paragraph 23, which is a transitional provision.

#### *Section 48: Scope of this Chapter*

193. *Subsection (1)* of this section provides for the Chapter to have effect where the services of a worker are provided through an intermediary.
194. *Subsection (2)* sets out that Chapter 7 of this Part, treatment of workers supplied by agencies, and section 555 of ICTA, payments to non-resident entertainers or sportsmen, both have priority over this Chapter. It derives from paragraphs 6 and 24.

#### *Section 49: Engagements to which this Chapter applies*

195. *Subsection (1)* sets out when the provisions of the Chapter apply. It derives from paragraph 1(1). There are three elements to be satisfied in order for the Chapter to apply:
  - an individual (“the worker”) personally performs, or is under an obligation to perform, services for the purposes of a business carried on by another person (“the client”)
  - the services are provided not under a contract directly between the client and the worker but under arrangements involving a third party (“the intermediary”), and

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- the circumstances are such that, if the services were provided under a contract directly between the worker and the client, the worker would be regarded for income tax purposes as an employee of the client.
196. *Subsection (2)* expands on the interpretation of “business” given in section 61 for the purposes of subsection (1)(a). That interpretation only extends to trades, professions, vocations and Schedule A businesses. This would not normally include the activities of, say, a Government Department delivering public services, so subsection (2) is needed to bring in the other instances where individuals provide services through intermediaries. It derives from paragraph 1(2).
197. *Subsection (3)* expands on the meaning of “third party” used in subsection (1)(b). If the intermediary is a partnership, the worker would be a member of that partnership – subsection (3) is needed to make sure that such a partnership (or other unincorporated association) counts as a third party for the purposes of subsection (1)(b). This material derives from the paragraph 1(1)(b).
198. *Subsection (4)* ensures that the wide phrase “the circumstances” used in subsection (1) (c) can include the terms on which the services are provided and the contractual arrangements under which they are provided throughout the whole chain of relationships between worker and client, rather than focusing only on the contract to which the worker is a party. This provision is drawn from paragraph 1(4).
199. This Chapter does not include the material in paragraph 1(5). That sub-paragraph said:  
The fact that the worker holds an office with the client does not affect the application of this Schedule.
200. Even without such a statement, the fact that a worker holds an office with the client has no relevance to the operation of these provisions. See *Note 12* in Annex 2.
201. *Subsection (5)* brings forward the explanation of the label “engagement to which this Chapter applies”. In Schedule 12 to FA 2000 the equivalent term is not explained until paragraph 21(1), although it is used several times in the early paragraphs of that Schedule.

***Section 50: Worker treated as receiving earnings from employment***

202. *Subsection (1)* describes what happens when all the relevant conditions (as set out in sections 51, 52 and 53) are met and the provisions of the Chapter apply. Where there is, in any tax year, a payment (or right to receive such payment) for services in circumstances as set out in section 49, and that payment is not chargeable to tax as employment income, then the intermediary is treated as making a deemed payment to the worker. That deemed payment is chargeable to income tax as earnings. (Later sections in this Chapter explain how to calculate the deemed payment).
203. The most notable change in this subsection from its source in paragraph 2(1) of Schedule 12 to FA 2000 is the new name for what was “the deemed Schedule E payment”, which has been shortened in common usage of that legislation to “the deemed payment”. To chime in with the language of Chapter 2 of this Part, this is now “the deemed employment payment”.
204. *Subsection (2)* sets out that a single deemed employment payment is treated as being made in respect of all engagements in relation to which the intermediary is treated as making a payment to the worker during the year. This derives from paragraph 2(3).
205. *Subsection (3)* sets out when the single payment mentioned in subsection (2) should be treated as being made. This derives from paragraph 2(2).

206. *Subsection (4)* introduces the label “relevant engagements”, which means any engagements in relation to which the intermediary is treated as making a payment to the worker during the year. This derives from paragraph 2(3).

***Section 51: Conditions of liability where intermediary is a company***

207. As suggested by the heading, this section is only of interest if the intermediary is a company. It derives from paragraph 3.
208. *Subsection (1)* sets out one negative condition and two alternative positive conditions. The negative condition is that the intermediary should not be an associated company of the client. If the intermediary is associated with the client then this Chapter will not apply.
209. *Subsection (2)* sets out a special test for whether the company is associated with the client for the purposes of this paragraph. It derives from paragraph 3(2).
210. It incorporates a minor change to the law. The normal meaning of “associated company” is given in section 416 of ICTA. That definition says that two companies are associated if one has control of the other, or if they are both controlled by the same person or persons. It is imported for the purposes of this Chapter by section 61. But paragraph 3(2) only envisages common control under a maximum of two people - the worker and another person. This subsection widens the definition of “associated company” for the purposes of section 51 to include companies that are under the common control of the worker together with more than one other person. See *Change 12* in Annex 1.
211. One of the positive conditions mentioned in subsection (1) is that the worker has a material interest in the company. This catches the most obvious cases where a company is being used as an intermediary, where the worker has some say in the operation of the company. *Subsection (4)* sets out the definition of “material interest” for this purpose. That definition includes a reference to “a participator”, a term which is defined in *subsection (5)*.

***Section 52: Conditions of liability where intermediary is a partnership***

212. As suggested by the heading, this section is only of interest if the intermediary is a partnership. It derives from paragraph 4.
213. *Subsection (2)* sets out the situations where liability may arise because the worker has a say in the operation of the partnership, whether that is because:
- the worker (alone or with relatives) is entitled to more than 60% of the profits of the partnership;
  - most of the profits of the partnership come from one client (or that client’s associates) in respect of services provided by the worker to which this Chapter applies; or
  - the worker is a member of the partnership whose share of partnership profits is based on the amount of income generated by his/her provision of services to which this Chapter applies.
214. The alternative test set out in *subsection (3)* is designed to catch the cases where the worker is not paid as a member of the intermediary partnership, but rather as an individual. This condition looks at what is actually going on between the worker, the intermediary and the client. It is satisfied if the worker receives (or is entitled to receive) direct from the intermediary something that can reasonably be taken to be remuneration for services provided to the client.

***Section 53: Conditions of liability where intermediary is an individual***

215. This section is only of interest where the intermediary is an individual. It is drawn from paragraph 4. The condition looks at what is actually going on between the worker, the intermediary and the client. It is satisfied if the worker receives (or is entitled to receive) direct from the intermediary something that can reasonably be taken to be remuneration for services provided to the client.

***Section 54: Calculation of deemed employment payment***

216. *Subsection (1)* sets out a method statement to show how to calculate the deemed employment payment. It derives from paragraph 7.
217. *Steps 1* and *2* contain a cross-reference to section 55, so that readers know where to find out what amount should be taken into account in respect of any benefits.
218. After *Step 2*, all the remaining steps deduct various amounts. *Step 3* contains a statement to the effect that if the result of that, or any later step, is nil or a negative amount, then there is no deemed employment payment.
219. *Step 3* also contains a cross-reference to the deductions provisions in Chapters 1 to 5 of Part 5 so that the reader can see where to look to find out what kind of expenses may be deducted.
220. *Step 8* of the method statement explains the operations involved in deducting the notional national insurance contributions.
221. The method statement concludes with a statement that the result represents the deemed employment payment.
222. *Subsection (2)* explains what to include in *Step 1* of the calculation of the deemed payment if the intermediary has received amounts under deduction of tax because of the operation of section 559 of ICTA (sub-contractors in the construction industry). It is drawn from paragraph 8.
223. *Subsection (3)* provides that amounts deducted at *Step 3* of the method statement may include certain reimbursed expenses. This derives from section 38(2) of FA 2002.
224. *Subsection (4) and (5)* provide that mileage allowance relief may be included in amounts deducted at *Step 3* of the method statement. This derives from paragraph 7B as introduced by section 38(2) of FA 2002.
225. *Subsection (6)* is new. It applies for the purposes of working out the amount to be deducted at *Step 3* of the method statement in respect of travel expenses. Entitlement to travel expenses depends on whether or not a workplace is “temporary” and where the worker is based over the course of the employment. *Subsection (6)* allows such travel expenses to be deducted at *Step 3* as would have been available during the combined period of all the relevant engagements as if that combined period was a continuous employment with the intermediary. This new rule is a minor change to the law. See *Change 13* in Annex 1.
226. *Subsection (7)* allows for mileage allowance payments or passenger payments to be deducted at *Step 7* of the method statement. This derives from paragraph 7B as introduced by section 38(2) of FA 2002.
227. It is quite likely that the intermediary will receive payments from the client to cover the services of more than one worker or to cover the services of a worker and other things (such as materials, reimbursed fees to third parties etc). *Subsection (8)* sets out that in such a case any apportionment required to arrive at the amount attributable to the services of a single worker should be on a just and reasonable basis. It derives from paragraph 9.

***Section 55: Application of rules relating to earnings from employment***

228. This section explains how to arrive at the amounts to be used in the various steps of the method statement outlined in section 54(1). It derives from paragraph 10. Broadly it specifies that the normal rules for computing employment income should apply when working out the amounts to go into the method statement.
229. One place where paragraph 10 departs slightly from the normal rule for employment income is in sub-paragraph (5), which deals with the time that a payment or benefit should be treated as received. This reads:
- ((5) A payment or benefit is treated as received-
- (a) in the case of a payment or cash benefit, when payment is made of or account of the payment or benefit;
- in the case of a non-cash benefit, when it is used or enjoyed.
230. *Subsection (5)* of this section provides a more detailed explanation of when a non-cash benefit should be treated as received. This is a minor change to the law. See *Change 14* in Annex 1.

***Section 56: Application of Income Tax Acts in relation to deemed employment***

231. This section ensures that the deemed employment payment is treated in exactly the same manner as if it were an actual payment of salary made by the intermediary, as employer, to the worker as employee. It derives from paragraph 11.

***Section 57: Earlier date of deemed employment payment in certain cases***

232. As set out in section 50(3) the basic timing rule for the deemed payment is that it is treated as being made at the end of the tax year in question. This section sets out what earlier date should be taken for payment of the deemed payment if there is a break in the worker-intermediary relationship during the tax year in question. It derives from paragraph 12, as amended by section 38(3) of FA 2002.
233. *Subsection (1)* sets the scene and says that where there is such a break (relevant event), then the deemed payment is treated as being made immediately before it, or before the first of them if there are more than one.
234. *Subsection (2)* lists the kinds of break in the worker-intermediary relationship that count as relevant events if the intermediary is a company. *Subsections (3)* and *(4)* list the kinds of break in the worker-intermediary relationship that count as relevant events where the intermediary is a partnership and where the intermediary is an individual.
235. *Subsection (5)* emphasises that this section only affects the time at which the deemed payment is treated as being made. It does not affect the calculation of the deemed payment, which is still based on amounts received in the tax year.

***Section 58: Relief in case of distributions by intermediary***

236. Where the intermediary is a company, it may pay distributions to the worker if the worker is a shareholder in the company. Since April 1999, UK companies have not had to pay ACT on distributions made. But the recipient of any distributions is taxable on them under Schedule F. So there is a possibility of double taxation in that the worker might have to pay tax under Schedule E on the deemed payment as well as on the actual amount of any distributions received. This section allows an intermediary that is a company to make a claim for relief to remove the possibility of double taxation. It derives from paragraph 13.
237. *Subsection (2)* describes how a claim to relief under this section should be made. It includes a statement of the time limit for such a claim. There is no specified time limit

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for making the claim in Schedule 12. This means the default time limit for claims (in section 43 of TMA 1970) applies, so that the claim must be made not more than five years following the 31 January following the tax year during which the distribution is made. That time limit is reproduced here to save users having to refer to another Act.

- 238. *Subsection (3)* describes the method of delivery of the relief claimed. It allows the Inland Revenue to direct that the relief be given by whatever means appears appropriate.
- 239. *Subsection (4)* makes it clear that in a case where there is a distribution and a deemed employment payment, it is the distribution that is reduced, by setting the employment income payment against it.

***Section 59: Provisions applicable to multiple intermediaries***

- 240. There may be a chain of intermediaries between the worker and the client.
- 241. *Subsections (2) and (3)* contain provisions derived from paragraph 16 concerning the intermediaries' responsibility to operate PAYE on deemed payments made to the worker. *Subsection (2)* makes all the relevant intermediaries involved in the same relevant engagement jointly and severally liable for amounts due as a result of the operation of PAYE on the deemed payment in respect of the engagement common to all the intermediaries, plus (if applicable) any other relevant engagements. *Subsection (3)* provides a get-out for any intermediaries who have not received any payments or benefits in respect of the common relevant engagement or any other relevant engagement.
- 242. *Subsections (4) and (5)* prevent any double counting of amounts when calculating the deemed payments of the intermediaries where there is more than one intermediary. It applies where there has been some kind of payment (or benefit provided) from one relevant intermediary to another in respect of a relevant engagement. In such a case, a reduction is made in the amount to be taken into account at *Steps 1 and 2* of the deemed payment calculation. This material derives from paragraph 15.
- 243. *Subsection (6)* says that, subject to subsections (2) to (5), the Chapter applies to each intermediary separately. *Subsection (7)* explains the label "relevant intermediary", used in this section. These two subsections derive from paragraph 14.

***Section 60: Meaning of "associate"***

- 244. This section deals with the meaning of "associate". This term is used in sections 50(1)(b), 51(3)(a) and (b) and 52(2)(b)(ii). It derives from paragraph 19.
- 245. The definition of an employee benefit trust now appears in Chapter 11 of Part 7.

***Section 61: Interpretation***

- 246. This interpretative section derives from paragraph 21.
- 247. *Subsection (1)* points out where the various terms used in the Chapter are defined.
- 248. *Subsection (2)* ensures that any payments or benefits received or receivable from a partnership or unincorporated association include any that a person is or may be entitled to receive in his capacity as a member of that partnership or association.
- 249. *Subsection (3)* treats anything done by or in relation to an associate of an intermediary as if it were done by or in relation to the intermediary. It also treats anything provided to an individual's family or household as if it were provided to the individual.
- 250. *Subsection (4)* treats (for the purposes of this Chapter) a man and a woman who live together as husband and wife as if they were married to each other. This extends into the definition of "associate" (defined in section 60(1) as having the same meaning as in section 417(3) and (4) of ICTA).