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Home > Accounting for payments from public bodies

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Accounting for payments from public bodies

Half-baked

KEY POINTS

- HMRC suggests two methods to deal with payments.
- Neither solution seems satisfactory.
- The public body is acting as an outsourced payroll service.
- Journal entries will correct and reconcile the position.
- Solutions that do not require a payroll for the sake of it.

I act on behalf of clients who are affected by the new rules in FA 2017, s 6 and Sch 1, which apply to public bodies if IR35 is thought to apply for their workers. To recap, the *Explanatory Notes*to the legislation state:

'The intermediaries rules apply where a worker would be regarded as an employee if their services were provided directly to the client, rather than through an intermediary, or the worker is an officeholder under the client and the services relate to the office. Chapter 10 [the new chapter introduced into ITEPA 2003, Pt 2 by FA 2017] moves the responsibility for deciding if these conditions are met from the individual worker's intermediary (including a personal service company) to a public authority, where the public authority is the client.'

As a result of this change, I had to consider how to account for such payments, particularly for the transfer of money to any directors and shareholders from their personal company.

HMRC suggests two alternatives for the proceeds received from invoices raised to public bodies that, since the new legislation, have operated PAYE on the amount due to the company:

- pay dividends, but do not put them on the client's tax returns; or
- put the money through PAYE, but do not tax it.

Further, sales to these companies should be ignored for corporation tax. After a meeting with HMRC, a tax lecturer noted that the department's advice was to 'credit debtors and debit sales' to remove the unwanted sales items from the limited company accounts. See HMRC's *Employment Status Manual* at ESM8000 et seq – tinyurl.com/y9692nf7 and the corporation tax point is dealt with at tinyurl.com/hff4hjw.

Instinctively, it seemed to me that this was a potential mess in the making. HMRC's advice appeared half-baked and inherently unnecessarily complicated.

Back to basics

I returned to first principles. In such circumstances, the public body or its agent is, in my view, acting as an outsourced payroll service for the one-man band company. So, journals are needed to reflect the director's salary. Further, PAYE income tax and National Insurance contributions are being deducted from the monies due to the company.

I put the two examples in this article, **University** and **Umbrella Company** to the ICAEW technical support who agreed with my proposals. The institute agreed that there was no point running payroll for a director with no tax deducted if it is solely to access the monies. This is because the net pay will be accounted for by the payroll journals because the body or a third party will have run the payroll for the company. Nor is there any need to vote a dividend that must then be left out of the director's personal tax return. If HMRC wants to view the position otherwise it is simply adding unnecessary complications to what is a normal, simple situation.

Public body payments

As can be seen from **University** and **Umbrella Company**, the net pay becomes a liability of the company and is entered in the director's loan account. Thus, they can draw on this without further ado or tax implications.

In **University**, the client's personal company rendered several invoices for the services of the director as well as VAT and expenses. The sales invoices have been processed through the sales ledger. The figures in total have been accounted for as shown.

In the other example, a worker is paid through an ***Umbrella Company***. The week's gross earnings are £557.27 (calculated at an hourly rate). The employer's class 1 National Insurance liability (£48.23) and apprentice levy (£2.53) were also passed on to the employee. The net amount of £506.51 was subject to PAYE.

UMBRELLA COMPANY

	Debit £	Credit £
Sales		557.27
Expenses		0.00
VAT		111.45
Trade debtors	668.72	
	668.72	668.72
Then:		
The net amount is received		
Bank	474.82	
Trade debtors		474.82

How to deal with the rest?
In my opinion, what is happening in reality is that a third party is running the payroll for the director on behalf of his company. So we get:

	Debit £	Credit £
Director's salary	506.51	
PAYE/NI control		143.14
Net pay control or DLA		363.37
	506.51	506.51

We also have a third party withholding and paying the PAYE/NIC on the company's behalf. Hence:

	Debit £	Credit £
Apprentice levy, PI insurance	2.53	
Employers' NIC	48.23	
PAYE/NIC control	143.14	
Trade debtors		193.90
	193.90	193.90

This clears both the PAYE/NIC control and trade debtors.

UNIVERSITY

The total invoice raised is £21,645.72. Of this £3,607.62 is VAT and the balance the fee plus expenses.

The university pays the service company £17,503.28. Of this £3,607.62 is VAT and the service company accounts for this as output tax on its VAT return in the normal way. The service company billed £17,900.75 fees and £137.35 expenses a total of £18,138.05. But as the fees were caught by the new rules the university deducted PAYE and NIC of £4,141.41 from this amount and paid a net £13,759.31. They also paid the expenses of £137.35. The position can be summarised:

	Invoice	*Payment*	*Difference*
Fee	17,900.75	£13,759.31	£4,141.41
Exp	£137.35	£137.35	Nil
VAT	£3,607.62	£3,607.62	Nil
Total	£21,645.72	£17,504.28	£4,141.41 *

* Being the PAYE and NIC deducted by the University.

	Debit £	*Credit* £
Sales		17,900.75
Expenses		137.35
VAT		3,607.62
Trade debtors	21,645.72	
	21,645.72	21,645.72

Then:

The net amount is received

Bank	17,504.28	
Trade debtors		17,504.28

How to deal with the rest?

In my opinion, in reality a third party is running the payroll for the director on behalf of his company. So we get:

Director's salary	17,900.75	
PAYE/NIC control		4,141.44
Net pay control or director's loan account (DLA)		13,759.31
	17900.75	17900.75

We also have a third party withholding and paying over the PAYE/NIC on the company's behalf. Hence:

PAYE/NIC control	4,141.44	
Trade debtors		4,141.44

This clears both the PAYE/NIC control and trade debtors.

Corporation tax

The other issue raised by HMRC is that the sales should be left out of the corporation tax computation. The sales must be included in the accounts because there is a legal arrangement between the company and the public body and a sales invoice must be raised. Again, the department's advice is unnecessary because the director's gross salary is the same as the sales invoice amount net of VAT and they cancel out.

The PAYE liabilities are cleared by a journal clearing the trade debtor that is not cleared by the money received. The public body has paid this difference to HMRC on the company's behalf so the public body no longer owes it to the company.

Conclusion

Having given this much thought, HMRC's advice appears to me unnecessary and poorly thought out. My questions to *Taxation* readers are: have I got this right; and am I missing something? If I am correct, someone needs to tell HMRC it has got it wrong.

My suggested solutions for dealing with the accounting emanating from the transactions in the examples do not require operating a payroll for the sake of it or raising dividends to extract money from the company for the shareholder.

Back to top

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[2] [2]

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