

# The Professional Passport Contractors Guide

## The Beginners Guide to Selecting Your Operating Structure



# An Introduction to Professional Passport



Crawford Temple  
Chief Executive Officer  
Professional Passport



Professional Passport started back in 2007 as a direct reaction to the MSC Legislation and the threat of debt transfer.

Working with HMRC to gain a full understanding of how they intended to apply the new legislation allowed us to develop the first provider audit standard of compliance in the market.

It is said that imitation is the best form of flattery and since our ground breaking work in 2007 others have tried to follow, with varying degrees of success. Professional Passport still remains the largest independent standard of compliance across the service provider sector.

Our audited and approved providers are relied on by some of the largest recruitment companies and their contractors.

Our unique IT contractors PI and PL insurance not only saves contractors money but ensures you only pay when you are contracting and it automatically covers the whole liability period; so you don't need run off cover - a further saving.

Our members helpline provides unlimited access to experts to help you with all your questions and queries; this is available to our Professional Members.

IR35 continues to be a concern for many contractors so our Contractor Guardian service ensures you get the most accurate assessment of your status for ALL your assignments in any 12 month period for a fixed fee. The service also ensures that you remain protected from Reasonable Care Penalties.

Professional Passport continues to grow and adapt our services to the market in line with the ever changing legislation. Almost a year ago now we launched our Network Jobs Site, once again a first in the market. The free to post networked jobs site was designed and developed as part of our early preparation for the Agency Workers Directive.

Our latest development, Professional Passport Formations, provides an online company formations service for contractors. This new portal allows contractors to form their own limited company electronically and provides possibly the fastest formation service available in the market.

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## Using this guide

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You can search the document using the key words search facility available on PDF documents.

## Need to discuss your individual situation with an expert?

Our professional members have access to our members telephone helpline that provides a range of experts to answer your questions across all of the key aspects relating to contracting.

Professional membership costs just £40.00 (+vat) per annum and you will have full access to the service for your whole membership year.

You can find out more about the helpline [here](#).

You can upgrade your membership to professional [here](#).

### Disclaimer Statement

The content of this guide is for guidance only and is not designed to replace your professional advisers or replace the need for professional advice. Whilst every care has been taken to ensure its accuracy in all cases you should seek your own legal and professional advice for your own situation.

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# Introduction

In the 80's the most common way of operating as a contractor was as a self-employed individual. This changed when in the late 1980's HMRC introduced a new rule making any recruitment company engaging self-employed workers liable for any unpaid tax if they failed to deduct full PAYE prior to payment to the contractor.

Almost overnight every recruitment company refused to deal with self-employed contractors; as they saw the risks and potential costs as too great; forcing contractors to set themselves up through their own limited companies. [The recruitment companies did not hold any liability for unpaid taxes where they dealt with a limited company]

The same rules applied to any end clients who engaged contractors directly so they too only wanted to contract with limited companies.

This rule; together with the subsequent introduction of IR35, created the range of operating structures we find in the market today. [You should be aware that there is a review of IR35 currently underway by the Office of Tax Simplification. A report will be provided to the Chancellor in time for him to adopt any recommendations in the 2011 Budget.]

The common feature across all the structures is that the contract between the agency [or in the case of an engagement directly with the end client; the end client] will always be with a corporate structure and not directly with the contractor.

With the wide range of structures available it can seem confusing as to which one is the right one; this guide attempts to cover each option in the simplest of terms and provide clear guidance on the differences.

The Professional Passport website also contains a set of simple tools to help you make your decision. Our hard and soft facts analysis allows you to answer a few simple questions and it will then provide you with a bespoke report based on your answers. These reports will highlight the most appropriate options for your personal circumstances together with some useful pointers in helping you select the right provider.

**You can access the decision trees and reports [here](#).**

*IR35 seeks to identify the true employment status ...*

*...either disguised employee or business relationship*



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# Introduction

We have also created a range of earnings calculators that allow you to personalise the illustrations showing your expected returns from each structure. We would emphasise that selecting your operating structure should not be based solely on which one looks to provide the best returns; there are many factors that need to be considered; which we cover through the guide.

**You can access the Earning Calculators [here](#).**

A key aspect in determining the most appropriate operating structure is the status of your assignment in relation to IR35. We have produced a Beginners Guide to IR35 to assist you in understanding this aspect.

**You can access the Beginners Guide [here](#).**

IR35 assessment is crucial and getting this wrong can have severe financial consequences. With the new heightened enforcement you are now more likely to be quizzed on your status by HMRC. For this reason we can provide you with a professional assessment of your status, including a report demonstrating that reasonable care was taken at outset to accurately assess the status.

**You can find out more about the assignment assessment service [here](#).**



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# Agency PAYE

Many recruitment companies have the option for contractors to work through the recruitment companies own PAYE service.

You will find that if you select this route you will be offered a lower rate than where you work through an external provider or your own limited company. This is because when you use the recruitment company service they have to account for employers NI, holiday pay and other statutory benefits such as sick and holiday pay, which they do not have to do when you engage through an external provider.

Your rate cannot be below the National Minimum Wage, as the recruitment company is subject to these rules just as any other employer would be.

This operating structure is ideally suited to lower paid contractors, typically rates below £8.50 per hour.

If you only intend to contract for a very short period it may also suit you.

One advantage of the agency PAYE route is that you are only dealing with one organisation and therefore it is the route that is the simplest and most straight forward.

There are very few instances where expenses for travel and subsistence would be allowed when using agency PAYE as each assignment is considered to be a permanent engagement and therefore does not qualify. To qualify for travel and subsistence expenses a workplace must meet the criteria for a temporary workplace. You can more information on these rules on our **website**.

Overall this structure will provide the lowest returns for most contractors.



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# Umbrella

Umbrella companies are limited companies that employ contractors.

Umbrella companies are used by many contractors as they provide a simple cost effective operating structure. There are no joining fees, no leaving fees and you only pay the umbrella charges whilst you are on active contract.

The umbrella typically includes required insurances within the price of the service; you should check with the umbrella and recruitment company exactly what insurances are provided and if there are any additional costs.

The contractor has an employment contract with the umbrella and the umbrella holds the assignment contract with the recruitment company, or in the case of direct assignments with end clients; with the end client.

The employment contract and associated operating procedures; when drafted and implemented correctly, create a style of employment commonly known as overarching employment. Where overarching employment exists it allows each workplace to be assessed as a series of temporary workplaces therefore allowing travel and subsistence expenses to be claimed; subject to other conditions being met. The Professional Passport website has further details on expense claims and these can be accessed by **clicking this link**.

It is this ability to claim expenses that is the main difference between an umbrella and agency PAYE.

Where a contractor operates through an umbrella company the rate offered by the agency is the same as if the contractor was engaged through their own limited company. This reflects the fact that employers NI, holiday pay and statutory benefits have to be accounted for by the umbrella company.

The introduction of the Agency Workers Regulations means that there are now two styles of umbrella on the market. Whilst the basic principles for compliance are the same there are some significant differences in relation to pay that contractors need to be aware of.

**We cover the two models in detail in our Contractors Guide to The AWR**

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# Umbrella

Where a contractor operates through an umbrella company they will usually be required to submit their timesheets to the umbrella. The umbrella then raises an invoice based on the agreed rate and submits this to the recruitment company for payment.

Some umbrella companies have close working relationships with the recruitment companies and have agreed their own processes; any umbrella you select will explain both the process and requirements for submitting your timesheets to you on joining.

You will often find that timesheets have to be submitted within certain time frames to ensure your payments are prompt.

Usually at the same time you submit your timesheet you will be required to submit claims for any allowable expenses you have incurred.

The levels of expenses automatically accepted, and the requirements for making claims, vary by umbrella company. You will see many umbrella companies refer to a dispensation.

A dispensation is an agreement between the umbrella and HMRC that allows the umbrella to accept certain levels of expenses without having to make individual reports at year end. It can also allow an umbrella to operate a sample checking of receipts associated to the expense claims made as opposed to checking every receipt; this is why some umbrellas refer to un-receipted expense claims.

Un-receipted expenses does not mean that contractors can claim for expenses they have not incurred. In all cases you should only make claims for expenses that you have genuinely incurred.

You will find a FAQ section towards the end of this guide.



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# Limited Company

Setting up and operating through your own limited company can appear on the surface to provide the best returns and therefore often seem like the most attractive option.

As we have stated previously, you should not base your decisions on how to structure your affairs based solely on the expected returns.

A limited company is a legal entity and where you set up your own, you as the director of the company, become responsible for meeting all the legal requirements and obligations associated with the company.

Below we have highlighted a number of key points you should consider, and be aware of, before deciding to operate through your own limited company. Whilst some of these may feel complicated, any accountant or specialist service provider will be well versed in the requirements and assist you in meeting these; that's what you pay them for. However as the director of the company it is you that ultimately holds the responsibility.

Following this key point summary we have provided an overview of the limited company options available to contractors.

You will also find a range of FAQ's at the end of the guide.

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# Limited Company

## Intentions - How long do you expect to contract for?

Whilst limited companies are relatively straight forward to set up; closing a limited company can bring with it, additional professional fees that would reduce, or in some cases remove, any additional returns anticipated at outset. For this reason we suggest that contractors only consider this option where they intend to contract for a period of no less than 1 year but ideally over 2 years.

You should also be aware that when you operate through your own limited company many of the requirements and legal obligations continue even when you are not on active contract. Where you use an accountant or specialist service provider you will continue to incur costs during these periods.

## IR35 status

The returns from a limited company will vary significantly depending on your **IR35 status**. It is essential that contractors operating through their own limited company take **professional guidance** on their status. In 2012 HMRC changed how they enforce IR35 which has resulted in a significant increase in the numbers of contractors being asked about their status. It is already clear that where a contractor can demonstrate they have fully considered their IR35 status the enquiries are being concluded quickly, this is not the case for those who have not considered status.

The difference between returns for a contractor invoicing around £75,000 per annum can be as much as £12,000. In some cases additional penalties could also be applied.

A professional review will cost you money, often not taken in to account in the many illustrations provided. Professional Passport has a service for their members that will review every assignment carried out in a year for a fixed fee of £199 (+vat). This professional review includes a conclusions report demonstrating that the status was fully considered resulting in a fast conclusion to any HMRC enquiry. The service now also includes free cover to the first stage defence.

Contractors earning in excess of £30,000 can still be better off operating through their own limited companies even where they are caught by the IR35 rules. (see deemed payment calculation)

*IR35 seeks to identify the true employment status ...*

*...either disguised employee or business relationship*

# Limited Company

## Financial awareness

When you operate through a limited company the income generated is the company's money.

You will be required to set up a company bank account and all money paid to the company must be paid in to this account.

You will also need to make provisions for future tax liabilities before considering how much of the company's income you can take for yourself.

This is an area that many contractors fail to fully understand.

If you do find that you have taken too much from the company and are unable to meet your future tax bills you will incur penalties; these can be significant.

For this reason any contractor looking to operate through their own limited company needs to have a good degree of financial awareness and discipline. You must not be tempted to dip in to the money set aside for future tax demands during periods where you are not working as this can trigger an expensive chain of events.

## Personal organisation

Running your own limited company will require a good degree of personal organisation.

As well as ensuring you submit your timesheets in the required time frames you will also have to produce your invoices to ensure you get paid; unless the recruitment company you work with operates self billing where they take care of the invoicing for you.

You will need to ensure that your PAYE and VAT returns are submitted and paid within the required periods to avoid penalties. Failure to do so can heighten the risk of an enquiry by HMRC.

You need to ensure that the deadlines for submission of accounts are met to avoid penalties.

You need to ensure your corporation tax liabilities are paid on time to avoid statutory penalties.



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# Limited Company

## Your risk profile

Contractors operating through their own limited companies have a higher chance of being investigated by HMRC.

Many of the decisions and actions you take in structuring your affairs through your company will either increase or diminish the risk of investigation. Therefore it is essential that, at outset, you decide what risk you are prepared to accept and ensure your decisions align to that profile.

Here are a few examples to illustrate the point:

As we highlighted earlier missing filing deadlines or making late payments on VAT, PAYE or Corporation Tax can increase your chances of investigation.

When you operate through your own limited company there is no requirement to pay yourself a salary, you could take all your income from the company as dividends. Whilst no one would suggest this, as it is not usually in your interest to do so, setting a low salary, say around the NI threshold of approx £6,000, with the remainder of the income being taken as dividends would be seen as aggressive and could increase the chance of investigation.

Including your spouse as a shareholder and paying them their share of declared dividends could also be viewed as aggressive by HMRC and heighten the risk of an investigation. You will find more details on this subject on our **website**.

Whilst we are not suggesting it is wrong to pay a low salary and the remainder in dividends, or to pay your spouse dividends where they are actively working in the business, as many do, we are merely pointing out the potential consequences of those decisions.

HMRC enquiries are the most common way that investigations in to the IR35 status of your assignments begin; we have more detailed information on this available on our **website**.

*IR35 seeks to identify the true employment status ...*

*...either disguised employee or business relationship*



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# Limited Company

As operating through your own limited company holds a higher risk of investigation we always suggest the following:

- Have all your assignments professionally reviewed at outset to confirm their IR35 status. As we have already covered this is essential to avoid reasonable care penalties. Having a professional review supported by a conclusions report can also stop any enquiry progressing in to a lengthy and time consuming dispute. If you are unfortunate enough to become the subject of an HMRC enquiry demonstrating that you have taken professional advice a outset, will be a key consideration for any inspector.
- We have a professional assignment review service that, for a fixed cost of £199 (+vat) per annum, reviews all your assignments for IR35 and provides a professional report documenting why that assessment was reached.  
**You can find full details here.**
- Any HMRC enquiry will require you to engage appropriate professional help to assist you in dealing with the enquiry; as well as increasing your chances of a positive outcome. As enquiries can be long drawn out affairs these fees can mount up. We believe that taking insurance to cover the cost of these additional professional fees is sensible and represents excellent value for money for contractors.
- We have a members scheme that is able to cover these additional fees for just £7.00 (+vat) per month. **You can obtain full details here.**
- We have provided a tool that will help you assess the risk associated with your remuneration strategy on our website. It will provide a bespoke report highlighting points you may wish to consider. **You can access this here.**

## Professional Indemnity and Public Liability insurance

Where you operate through your own limited company you may be required to hold additional insurances, such as Professional Indemnity and Public Liability. In many cases having this insurance will be a contractual obligation.

Your recruitment company will be able to advise you on any specific requirements relating to your assignment.

This is an additional cost you must consider as umbrella companies provide this within their standard offering.

Professional Passport has a members scheme available for IT contractors and you can access full details **here**.





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# Limited Company

## Provider compliance

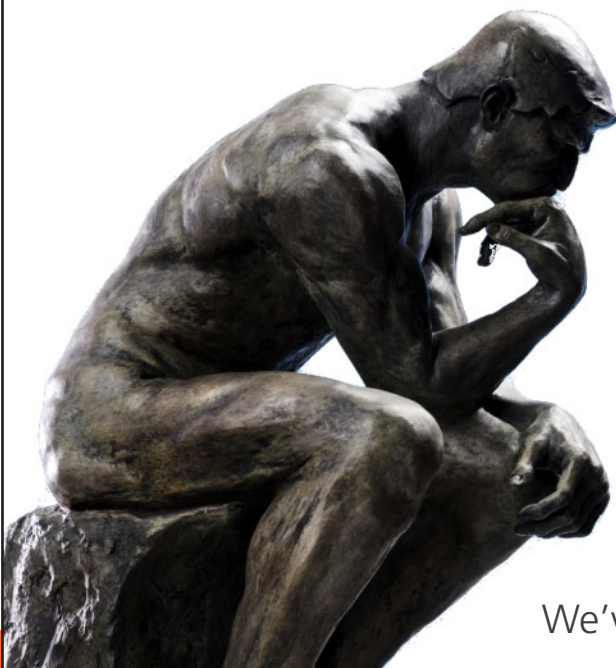
In 2007 HMRC introduced a new piece of legislation; **The MSC Legislation**. This legislation sets out the parameters of service, support and advice that can be supplied to contractors operating through their own limited companies. If a provider fails to meet these requirements it prescribes that all income from the company must be taken with full PAYE deducted, regardless of IR35 status. Any accountant or provider who describes themselves as specialists in the contracting market must consider this legislation when providing their services.

Non compliance will lead to additional tax liabilities and recovery of these is always made from the contractors in the first instance.

This legislation is complex and difficult for contractors to understand meaning that many could unwittingly find themselves subject to additional tax demands as a result of actions taken by their accountant or provider. To assist contractors with selecting a compliant provider Professional Passport carries out audits on providers to assess their compliance with this complex legislation. You can find a list of those providers who have successfully passed our audit at the back of this guide or you can view them on our website [here](#)

We have also developed a tool to help you assess the compliance of your current provider. This provides a bespoke report highlighting areas you should be aware of and address with your provider. You can access the MSC risk profiler [here](#).

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# Limited Company

## Limited Company Options

### Limited company outside IR35

#### Income

Where your assignments are assessed as outside IR35 you have complete flexibility on how you take your income from the company.

You can set a salary level, aligned to your risk profile, and take the remaining income through dividends, after you have calculated any Corporation Tax liabilities that would be due on the profits.

#### Why take income through dividends?

In UK tax law dividends are seen as a return of the investment made in to a company and therefore have a different tax regime applying. Any income you take as salary is subject to the PAYE rules which includes payment of National Insurance by both the employer and employee. As you are effectively the employer, as you own the limited company, you are required to pay the employers NI contributions. Payments made as dividends do not attract any National Insurance contributions by either the employer or employee; therefore these payments are a significantly more tax efficient way of taking income from a company.

#### VAT

Where your turnover exceeds a prescribed amount you are required to register your business for VAT. If your anticipated turnover is below the registration threshold you can, if you wish, voluntarily register for VAT.

Within the VAT system there is a simplified reporting structure available known as The Flat Rate Scheme. Many contractors can find registration for VAT under The Flat Rate Scheme beneficial. You can only use The Flat Rate Scheme where your business qualifies, an upper threshold exists on the turnover of the business. If your business exceeds this threshold you will have to deregister for The Flat Rate Scheme. You will still have to remain registered for VAT as the threshold is in excess of the registration threshold.

In the simplest of terms if you anticipate having a low level of expenses through the business, as many contractors do, then The Flat Rate Scheme can provide additional profits to the business.

continued ...



# Limited Company

## Example Calculations

Normal VAT at 20%, £5,000 a month billings, £100 per month purchases.

VAT due on sales = £1,000

VAT reclaimed on purchases = £20.00

VAT due = £980.00 [sales - purchases]

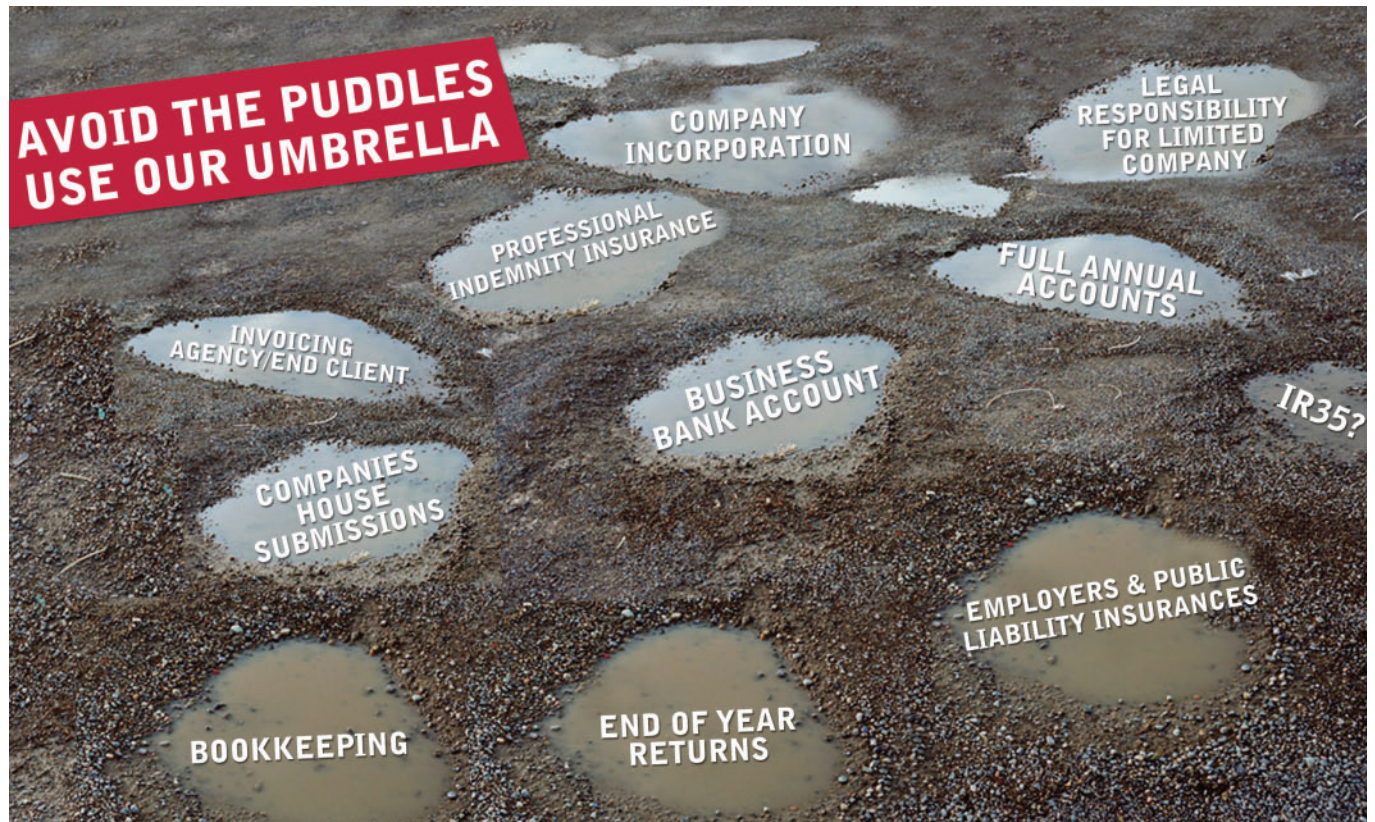
Flat Rate Scheme: IT contractor rate of 13%, £5,000 a month billings, £100 per month purchases.

VAT due = £763.75

On The Flat Rate Scheme the applicable percentage is applied to the sales [including VAT] and any VAT on purchases is ignored.

In this example a contractor would benefit by £216.25 per month, or £2,595 per annum, simply by registering for The Flat Rate Scheme.

Whilst Corporation Tax would be due on this additional amount it still provides additional income.



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# Limited Company

## Limited Company Options

### Limited company inside IR35

#### Income

Where your assignments are assessed as inside IR35 you are required to account for your income using The Deemed Payment Calculation.

In the simplest of terms; The Deemed Payment Calculation allows you to take 5% of the income from an assignment as a gross payment; ie no tax or NI applied. This is designed to cover your costs in operating your limited company. In most cases the remainder of the income from the assignment would have to be taken as PAYE income.

This is likely to reduce your overall returns as PAYE requires the payment of Employers National Insurance therefore reducing the overall amount available as salary before applying the Employee PAYE tax and National Insurance.


Although you can take an allowance of 5% to cover expenses this relates to the calculation of your PAYE liabilities. If you do not incur costs covering the full 5% allowance corporation tax will be payable.

#### VAT

The same rules apply to VAT registration regardless of your IR35 status.

Where you register on the Flat Rate this will change how the 5% allowance is calculated; your adviser will be able to explain this fully to you.

Additional income resulting from membership of the Flat Rate VAT Scheme must be taken as salary and taxed through the PAYE system.



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# Limited Company

## Limited Company Options

### **“The One Person Umbrella”**

Part of the objective of The MSC Legislation was to force contractors who operated through their own limited companies to take more responsibility and become more actively involved in the running of the company.

HMRC saw this as a way of limiting the numbers of contractors who would operate through their own limited companies but who were not genuinely in business in their own right; as well as forcing increased compliance across the provider community.

The MSC Legislation limits the involvement a provider can have in supporting a contractors limited company; where they become too involved a set of tax rules apply to that company prescribing that all the income has to be taken with full PAYE tax applied.

By applying PAYE tax on all the income this provides a reduced return when compared to The Deemed Payment Calculation; as in that case there is a standard 5% allowance for the running of the company.

Since the introduction of The MSC Legislation a combination of factors has resulted in a position where contractors that have low expense claims could be better off working through a limited company, and applying the MSC rules to their income.

In these cases the contractor would still be a director of their own company but the service provider would deliver a much higher level of support, taking over many of the responsibilities. In doing so the limited company becomes a MSC under the terms of the rules which is not an issue where full PAYE is applied. The levels of support provided can make this structure feel very similar to operating through an umbrella; probably explaining why many providers who offer this service describe it as The One Person Umbrella.

Another key difference with an MSC is that in the vast majority of cases it does not have the ability to apply any allowance for travel and subsistence expenses; as each assignment is classed as a series of permanent placements, in the same way as Agency PAYE. Therefore it is likely to only provide a possible option to contractors who have little or no expenses to claim.

*IR35 seeks to identify the true employment status ...*

*...either disguised employee or business relationship*



# Limited Company

## VAT

This structure has all the same rules applying to it for VAT registration and the use of The Flat Rate Scheme.

Use of The Flat Rate Scheme will in many cases provide additional benefits, as we have illustrated in the previous examples.

In these cases the additional benefits can mean that where contractors have low levels of claimable expenses through an umbrella this structure can provide a viable alternative.

Any additional income resulting from membership to The Flat Rate Scheme must be taken as salary and taxed through the PAYE system.

## DON'T GAMBLE ON STATUS



### IR35 STATUS



**Now includes FREE Defence Cover on IR35 Investigations for the new 1st Stage**  
PROTECT YOURSELF FROM PENALTIES.

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## Self- Employed

There are a number of self-employed offerings available to contractors; these are particularly prevalent in the construction sector.

In all cases the self-employed worker engages with a providers limited company and this company contracts with the recruitment company or end client. This contractual chain allows recruitment companies and end clients to remain protected against any unpaid taxes of the worker as they are contracting with a limited company.

Professional Passport does not currently audit these arrangements.

HMRC carried out a consultation on False Self-Employment in the Construction Sector last year. Whilst there were no immediate amendments changes are widely anticipated although these may not be until 2012. If and when changes are announced and the area is clarified we will review and amend as appropriate our audit standards.

The MSC Legislation makes no differentiation between whether you are employed or self-employed; it tests whether the structure is caught by the rules and where it is, a calculation is carried out to establish the tax that would be due if full PAYE were applied. This is compared to the tax paid and where there is a shortfall a demand would be issued to the contractor for the shortfall.

## Offshore

A number of providers are either based offshore or provide offshore solutions to contractors; these are often aimed at overseas workers currently on contract in the UK.

Following the Pre Budget Statement in December 2004 the lines between tax avoidance and tax evasion have become increasingly blurred with Government and HMRC taking a zero tolerance stance in this area.

The MSC Legislation can be applied to many of the offshore offerings.

HMRC have taken the stance that where income is generated from work carried out in the UK then that income must be paid in line with rules applicable in the UK.

As the providers are offshore, and therefore outside the jurisdiction of HMRC, should any of these offerings be challenged the challenge is likely to be directly to the contractor, not the provider. It will be the contractors responsibility to prove compliance.

continued ...

Many recruitment companies will not deal with offshore providers. A recruitment company must make payments in to a UK bank account to remain protected from potential liabilities. Where this is not the case the recruitment company could also become exposed to the risk of debts.

Recruitment companies also have obligations to ensure they are not colluding in tax evasion. Where they are aware that an offering is offshore they may choose not to contract with that provider for their own protection.

We believe that the increased risks in this area now outweigh any potential benefits offered.

You will find a range of articles we have written on this subject in our Newsletter section on the website. This can be accessed using **this link**.

## Employee Benefit Trusts [EBT's]

The typical structure for an employee benefit trust would be:

- The contractor is employed by a company
- The company pays the contractor a low salary
- The balance of the income is paid by a trust in the form of loans to the contractor

The presentation is centred on the fact that loans do not need to be declared as income, and so are effectively tax free at that time. If the loan is written off then this is the point it becomes income and has to be declared.

Whilst it is entirely possible for companies to operate EBT's compliantly, and many do; where the arrangement is considered "manufactured" there is a significantly higher chance of this being challenged by HMRC.

continued ...

*IR35 seeks to identify the true employment status ...*

*...either disguised employee or business relationship*

Many contractors select these structures as they feel that the chances of being caught are slim and so worth the risks; as the initial returns are often marketed at over 85%. There are two key points that must be considered here:

- As the contractor is employed and paid salary all these companies make returns to HMRC providing full details of all workers employed during any given tax year. Therefore once a scheme is identified it is a relatively straightforward process for HMRC to identify all those involved.
- Assuming the structure was operated compliantly the headline rate marketed would be correct; however, many of the promoters fail to highlight the long term position and therefore the ultimate returns that could be expected. The key word in the description of these offerings is loan. A loan is just that and is required to be repaid at some point in the future; therefore making the arrangement no more than tax deferred. As every financial expert is predicting tax rates to rise significantly as a result of the economic downturn we fail to understand why deferring tax to a point where rates will be higher could be a good idea.

Furthermore, a key aspect in running a compliant EBT is the wording contained within the loan contract. All loan contracts allow the loans to be recalled at any time and have no obligation for the trustees to pay out any of the money to the employees. This raises further issues that must be considered:

- At any point in the future the providers could decide to write off the loans as they are no longer acquiring new business at a level that makes it economic to continue. Where loans are written off this is the same as receiving that money as income and you would be required to declare that income in that specific tax year. This could occur in a year where you have high earnings and therefore become subject to higher rates of tax than you would have paid originally. Failure to disclose the money is tax evasion and holds serious penalties.
- Where repayment of the loans is demanded you are legally bound, through the original loan contract, to repay that money. Once repaid there is no requirement for the trustees to pay that out to the workers; it can be retained. Any assurance of repayment made by providers is likely to mean that the EBT fails the compliance test.

For all of the above reasons Professional Passport does not audit providers with these types of arrangements.

# Umbrella Questions and Answers

## **Who could be suited to operate through an umbrella?**

Contractors earning upwards of £8.50 per hour who have expenses that can be claimed.

Contractors who are uncertain of the length of time they intend to contract and therefore do not want to make long term decisions at this time.

Contractors who know their assignments are within IR35 and do not want to manage their own limited company.

Risk adverse contractors who just want someone else to take care of all their affairs.

## **There are so many umbrella companies how do I know which one to choose?**

The first point to be clear on here is that, all umbrella companies apply the PAYE tax system to your income so there will be little difference between the returns from each. Whilst initial illustrations may provide a range of returns, the reality is that many of these will not accurately assess your personal circumstances and are designed to present the best return.

The two factors that influence your returns from an umbrella provider are:

Their charges; the more they charge for the service the less you will ultimately receive. In real terms this only results in small differences in overall income received as charges are taken before tax and so the overall impact of charges is reduced.

continued ...



# Umbrella Questions and Answers

**There is a list of our approved providers at the back of the guide or you can view the list on our website [here](#).**

**I have little or no expenses I can claim, is an umbrella still going to be right for me?**

The level of expenses you are able to claim. As expenses are paid without deduction of tax this reduces your tax and increases your returns. This is why so many umbrella companies market their “generous expense policies”.

You should always select an umbrella; whose way of operating, you feel, suits your style and, that you are confident operates compliantly. Professional Passport audits umbrella companies and provides a list for our members of those that have successfully passed our audit standard; probably the toughest assessment in the market.

If you have little or no expenses to claim, you have no tax advantages you can use to offset the umbrella charges. This does not mean the umbrella is not right for you as the other options that you could explore may not meet all of your other requirements. As we regularly point out; basing a decision solely on your expected returns is not the best answer, and over the longer term could become more expensive overall.

If you are earning up to £12.00 per hour, agency PAYE may provide an alternative; this will be subject to the rate the recruitment company will offer for their PAYE solution.

If you have a higher rate you may consider your options with limited company, even where you are caught by IR35; the deemed payment route can still provide good returns for those caught by IR35.

continued ...

Although you will lose the simplicity of the umbrella operation and will incur some charges even when you are not contracting. This is covered in the limited company section of the guide.

Some providers are now offering what is often referred to as a one person umbrella company. This is covered in the limited company section of the guide and maybe worth exploring.

## **Why do I seem to be paying the employer's NI shouldn't that be the umbrella's cost?**

This is one of the most common misunderstandings by umbrella workers.

As you are an employee of the umbrella your income is as described through your employment contract; as we covered earlier this is typically a salary at National Minimum Wage with bonuses when on assignments. Your entitlement is not the full value of the invoice.

The value of the bonuses are determined once the umbrella margin, your salary, employers NI [on both salary and bonus payments] and allowable expenses have been taken in to account.

In reality you receive the exact same money as if you were operating through your own limited company; applying the same payment rules.

Remember your rate was enhanced over the rate offered under Agency PAYE to take account of these additional costs.

# Umbrella Questions and Answers

**Is there a difference between an onshore and offshore umbrella?**

Yes.

Under UK employment law the umbrella is responsible for ensuring compliance to the laws. If HMRC were to challenge an umbrella's compliance, it is the umbrella that would be liable for any additional taxes assessed.

You should be aware that many of the umbrella's, within their contract, reserve the right to recover these taxes from the contractors. Whilst they have this right if you follow their procedures and ensure you only claim expenses aligned to their policies it is unlikely that you will be pursued for any additional taxes.

The situation for offshore umbrellas is different. An offshore umbrella falls outside of HMRC's jurisdiction and therefore also falls outside of the UK employment laws. If HMRC were to challenge the compliance of an offshore umbrella they are likely to seek any additional taxes assessed directly from the workers.

**Is there any risk where I use a UK umbrella and stick to their rules?**

The risks in this example are minimal.

The only risk to a contractor is where the umbrella goes into receivership or administration. In these cases their legal obligation on pay is to pay you the National Minimum Wage; therefore additional income from the assignment could be at risk and held by the administrators.

continued ...

Selecting an umbrella from our approved provider listings minimises this risk as we have carried out a financial due diligence health check as part of their audit.

Most recruitment companies ensure their contracts with umbrella providers allow for immediate termination in these cases. If this is present in the contract the risks are minimal as in most cases you will be paid on all your money due on a weekly or monthly basis.

If an umbrella is holding back holiday pay and only paying this as requested; this fund could be lost if the umbrella ceased trading.

To keep this in perspective the risks are no more or less than those with any company you deal with going bust.



# Limited Company Questions and Answers

**Can anyone operate through their own limited company?**

In theory yes; so long as you are not disqualified from being a company director.

The key consideration is not whether you can operate through your own limited company more whether you are suited to it and whether it provides enough additional benefits to make it worthwhile. as we have tried to highlight there are a range of things to consider to be able to answer this question.

**What are the real chances of being investigated?**

This is impossible to predict.

Over the last few years HMRC have added a number of additional questions to returns made by both individuals and companies. The responses to these questions allow them to more accurately identify potential targets for investigation.

As HMRC resources are limited they will often apply a risk assessment when deciding on who to investigate.

Throughout the guide we have tried to highlight areas that could heighten your risk profile and in turn increase your chances of investigation.

Even where you are investigated, demonstrating that you have at each stage acted appropriately can mean that the investigation is concluded quickly and without additional liabilities.

**Will HMRC always apply penalties?**

History shows us that where penalties can be applied they will be, often at the highest rate possible. continued ...

There is an element of protection that is provided by the European Court based on a proportionate level of penalty; although if it reaches this stage of the argument you will probably have greater things to worry about.

Where you have taken the appropriate steps this will prevent penalties from being applied, even if they disagreed with your conclusions. The key part to remember is that the onus is on you to demonstrate you took those steps at the time; a simple explanation is unlikely to be considered as demonstration of the facts.

## **If I am investigated what should I do?**

The first thing you should do is to engage a professional adviser to assist you in the investigation. You may not realise that you are being investigated as it can often start with what appears to be a simple visit to your business. In all cases we suggest that a professional adviser is present for any visit.

Where you have had your contracts reviewed professionally that firm is likely to be keen to support you as it is their advice that could be challenged. In those cases you should contact the firm immediately and seek their guidance.

If you have taken an insurance policy to cover any additional fees as a result of an investigation you should contact the insurer immediately to seek their guidance. You will probably find that this is a requirement of the policy.

# Limited Company Questions and Answers

**Why should I take any of my income as salary as this seems an expensive route?**

Ensuring your salary at least meets the National Insurance threshold provides qualifying years for future state benefits like the State Pension; failing to meet these levels will impact your ability to claim future benefits.

As we have also pointed out the lower the salary the higher the likelihood of an investigation; especially where you take dividends every time you take a salary.

Ultimately only you can decide what you consider to be appropriate levels and align these to your own attitude to risk.

**What costs do I need to consider when comparing returns?**

Where you operate through your own limited company you are likely to be required to hold professional indemnity insurance as a minimum. This is provided within the cost of the umbrella offering.

Professional indemnity insurance will cost varying amounts depending on your market; you should find out how much this is for your circumstances and include this cost in your calculations.

We have a members scheme for IT contractors and you can obtain a quote **here**.

You may also be required to hold public liability insurance as well as employers liability insurance; we have provided an over view of these on the website and you can find details **here**.

continued ...

# Limited Company Questions and Answers

Whilst you are likely to incur additional costs you are also likely to be able to claim for more things when you operate through your own limited company. The balance between the two can often mean that when both sides are considered the overall position is neutral.

## **How do I select a provider?**

As this is The Beginners Guide we would suggest you select a provider that understands the complexities and nuances relating to the contractor market.

They are more likely to be able to provide detailed guidance and support in many of the key areas.

There is a list of our approved providers at the back of this guide or you can view a list of audited and approved providers on our website that you can access from **here**.

## **I am being asked to confirm that I am in business on my own account, if I don't I am told that I will be inside IR35 what should I do?**

This all relates to regulations known as The Agency Workers Regulations and where you obtain an assignment through a recruitment company you could potentially be caught by them

**We have written a specific guide for contractors on this and you can access it here.**

*IR35 seeks to identify the true employment status ...*

*...either disguised employee or business relationship*

# Audited and Approved Umbrella Providers



0845 20 20 360  
info@360-group.com  
www.360-group.com



0151 449 3500  
paul@i-pay.com  
www.i-pay.com



01932 33 44 55  
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0208 735 6370  
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0800 848 8888  
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www.crystalumbrella.com



0800 1216513  
enquiries@paymatters.co.uk  
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0207 374 6957  
info@cxcglobel.co.uk  
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0800 197 6516  
membership@paystream.co.uk  
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01253 600140  
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www.danbro.co.uk



0845 604 0571  
info@racsgroup.com  
www.racsgroup.com



01332 595959  
contactus@simplifybusiness.co.uk  
www.simplifybusiness.co.uk



# Audited and Approved Accountancy Service Providers



0800 089 0110  
helpdesk@1st-option.co.uk  
www.1st-option.co.uk



0208 735 6370  
info@lesters-uk.com  
www.lesters-uk.com



0845 20 20 360  
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www.360-group.com



0845 603 8088  
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01942 684769  
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0800 1216513  
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