



What is an Umbrella Company?- Self Help Guide

An umbrella company is a company that acts as an employer to agency contractors who work under a fixed term contract assignment, usually through a recruitment employment agency in the United Kingdom. Recruitment agencies issue contracts to a limited company as the agency liability would be reduced. It issues invoices to the recruitment agency (or client) and, when payment of the invoice is made, will typically pay the contractor through PAYE with the added benefit of offsetting some of the income through claiming expenses such as travel, meals, and accommodation.

Umbrella companies have become more prevalent in the UK since the British government introduced so-called "IR35" legislation that creates tests to determine employment status and ability to make use of small company tax reliefs. According to criteria set out by the UK Department for Business, Innovation & Skills, there are an estimated 4 million temporary workers in the UK, of who 1.56 million are "classed as being in a management or senior official role, a professional occupation or an associate professional and technical occupation." It is estimated that 14% of the UK's professional contractors are currently managing their business by working through an umbrella company.

How does it work?

An umbrella company processes timesheets received from the employee/contractor, then issues an invoice to the client for payment.

The umbrella company provides payroll services on behalf of the contractor and bills the agency (who in turn bills the client) for work completed by the contractor. The umbrella company provides all social contribution and tax payments (in some countries also "PAYE, Pay As You Earn" and equivalents and National Insurance returns on behalf of the contractor.

The client is effectively the company for whom the contractor works. This may be within any industry and across all levels of employment. The client often elect to use contractors as it affords them the ability to temporarily augment their staff or capability without the burden of the legal requirements associated with permanent employees (PAYE, NI, sick pay, insurances et al.). Using contractors also facilitates special skills and typically provides the advantage of a broader skill set as the contractor has typically worked many companies and organizations during prior contracts.

The agency, if involved, performs the recruitment process on behalf of the client. Some agencies will provide a PAYE scheme as part of their service. This alleviates the requirement for the umbrella company but requires additional capability within the organisation including professional accountants and adherence to fiscal laws. Most agencies elect to utilize an umbrella company.

The contractor or employee completes the actual work, completes a timesheet and submits this (typically via fax or secure web portal) along with expense claims to the umbrella company.



Expenses and taxes

All umbrella companies use the same PAYE calculations to ascertain how much tax should be paid. The only difference between umbrella companies will be the fee that they charge and the level of service that they offer to their customers.

Some of the most common "allowable" expenses include: Mileage & general travel expenses, hotel and accommodation expenses and Professional Subscriptions. Food and subsistence is rarely allowed to be claimed, as it is the HMRC's opinion that you would eat regardless as to whether you are working or not. The exception to this rule is if you were staying away from home as part of the work.

Whilst many of the umbrella companies advertise similar offerings, much of the detail should be checked by the user. Often expenses are used as a selling point with potential abuse of "dispensation" (HMRC issue documentation to employers as a more effective way to record Expenses rather than as a method of generating more income) agreements. It is the independent contractor who will be liable should HMRC decide, for instance, that expenses have been incorrectly claimed. A dispensation is simply a working agreement between a company and HMRC. It is a cost saving mechanism for HMRC that helps them reduce the number of tax inspectors.

- A dispensation does not benefit a contractor
- A dispensation does not mean less paperwork for a contractor
- A dispensation does not affect what a contractor can claim as a legitimate business expense

A dispensation is, primarily, a means of reducing HMRC paperwork, by estimating the value of multiple small transactions rather than itemising each one.

The 2008 HM Treasury pre-budget report, reported on the consultation on the use of travel expenses in conjunction with being employed via umbrella companies. The document questioned the validity and fairness of allowing business expenses in this form suggesting that an overarching employment contract was not a form of employment that allowed travel and subsistence expenses. HMT decided that the legislation would remain as is but suggested additional HMRC policing would be carried out to reduce cases of non-compliance. HMT issued the results of the consultation in December 2008.



Charges

Umbrella companies normally keep a small part of the income or charge a small fee for processing contractors' payroll and for some umbrella companies it will go towards contractors insurances. In France, Belgium and Sweden, it is usually a percentage of the invoiced amount. In the UK, it is mostly a fixed weekly amount.

Most of the UK-based umbrella companies advertise two types of charges.

Gross charge: fee that is deducted before tax. This is the actual charge that umbrellas deduct.

Net charge: for marketing reasons, many umbrella companies list their net charges, i.e. equivalent charges of gross charge 'after tax'. This is to make charge appear small.

Calculations of net charge are simple. For example, if an umbrella charges gross 26.5 per week before tax, the net equivalent of this amount is, if contractor is a basic rate tax payer (i.e. 20% tax) : $26.5 - 0.2 \times 26.5 = 21.2$ pounds. If contractor is a higher-rate tax payer (i.e. 40% tax): $26.5 - 0.4 \times 26.5 = 15.9$ pounds. There is small fraction of umbrella companies that charge a percentage of a contractor's earnings, e.g. 15% of contractor earnings.

In some cases, there is an additional deduction made by the umbrella company on behalf of the "contractor". This deduction is made to pay the employer's NI at source and is usually passed on by reputable recruitment companies in order to ensure that the "contractor's" income isn't adversely affected.