



'THERE'S NO SUBSTITUTE FOR EXPERTISE'

Payment Options Comparison

PAYE, Umbrella or Limited Company?

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Should you work under PAYE, an Umbrella Company or a Limited Company?

As a contractor you have three options when it comes to working in the industry. Each option has positive and negative attributes. This article is for the purpose of explaining each option; the tax associated and will end with M J Kane's recommendation.

Each option will have a take home pay example based of a £50,000* yearly wage. As the title suggests the three options available to a contractor are;

1. PAYE
2. Umbrella
3. Limited Company

*Figures are based on the 2018/19 tax year. Taxes are dependent on the individuals own personal circumstances. All figures used are an approximation and cannot be used as a determination for any one individual. Corporation tax rate of 20% used.

▪ PAYE

PAYE involves a contractor working as an employee of a company. Under a PAYE scheme your employer deducts tax and National Insurance contributions from your wages. This means that you pay tax throughout the year without having to pay any lump sums at year-end.

At the end of the tax year, you will get a form P60 that sets out the total amounts paid to you and the total tax and National Insurance amounts deducted from you for that tax year.

The benefits of being in a PAYE Job are that the employee has job security, they are also entitled to holiday pay, sick pay and any other benefits the company offers their employees. Employees have a high level of security because they are protected by U.K. Employment legislation and have a set income that will rarely fluctuate.

However, under a PAYE scheme an employee will stand to lose a substantial amount of money from their gross wage in tax & National Insurance deductions.

For example, a gross income of £50,000 will equate to a take home pay of £37,016.

See breakdown below:

Detail	£
Gross Income	50,000
The Taxable Amount	38,150
Less Tax	8,360
Less Employees NI	4,624
Take Home	37,016

Through PAYE an employee will stand to lose out on 26% of their yearly income to tax and National Insurance contributions.

▪ Umbrella

With an umbrella company, most of the daily operating is similar to that of PAYE.

An umbrella company is a company which acts as an employer to contractors who are typically working under a fixed term contract assignment, usually through a recruitment/employment agency. The recruitment agencies issue contracts to an umbrella company so that their financial liabilities are reduced

Similarly, to PAYE, an umbrella company will use the same calculations to ascertain the weekly tax liability of the contractor. The benefits to an individual of using an umbrella company are that all the tax related workings and deductions are carried out and managed by the umbrella company.

Umbrella companies can, but do not always, provide benefits to contractors such as standard statutory payments like Statutory Sick Pay (SSP), Statutory Maternity Pay (SMP), Holiday Pay etc. Under an umbrella company an individual will have to pay additional tax in the form of Employers National Insurance contributions. Contractors will also be expected to pay a fee for the services provided. Umbrella fees are generally around £25 per week.

For example, if we take a gross income of £50,000 this will equate to a take home pay of £30,012.

See breakdown below:

Detail	£
Gross Income	50,000
The Taxable Amount	38,150
Less Tax	8,360
Less Employees NI	4,624
Less Employers NI	5,704
Take Home	31,312
Umbrella Service (£25 pw)	1,300
New Take Home	30,012

Through an umbrella company an individual will stand to lose out on 40% of their yearly income to tax, National Insurance contributions and service charges.

▪ Limited Company

A limited company, simply put, is a business structure that has its own legal entity. It is completely separate from its owners. The 3 main benefits of a limited company are:

1. It can enter into contracts in its own name;
2. It can become VAT registered. Allowing for an additional 20% to be charged on top of its current sales; and
3. The owners of a limited company are protected by 'limited liability', which means they are only responsible for business debts up to the value of their investments into the company or what they guarantee on behalf of company.

The job security of a contractor operating through a limited company is poor. Contracts can generally be terminated without reason at any time. As a director of a limited company, the contractor will have legal requirements. They will have to produce an annual set of accounts, file a confirmation statement, complete a company payroll and file quarterly VAT returns (If VAT registered).

Setting up a limited company is the easy part; either the director or, more commonly, an accountant can do so on Companies House.

After this a contractor will need the help of an accountant. When it comes to producing accurate accounts, VAT returns, processing payrolls and general financial issues associated with a company, using an accountant is the best way to ensure these are handled correctly and with tax efficiency.

Unlike PAYE and umbrella, the director is solely responsible for the tax associated with the company, as mentioned earlier, with PAYE the individual's tax is deducted throughout the year, however, with a limited company, typically, tax is paid in a lump sum at the end of the year (depending on circumstances).

When we look at the main perks of a limited company, the option for VAT registration and limited liability, we start to understand why it is such a popular option for contractors.

A company registered for VAT will receive an additional 20% on top of its sales and will need to produce quarterly VAT returns. A contractor's limited company will typically be registered on a VAT Flat Rate Scheme which can allow them to benefit from lower VAT percentage rates and therefore retain a significant portion of the VAT received.

For example, if we, again, take yearly earnings of £50,000 and we VAT register the company we walk away with a gross income of £60,000. VAT bills are typically around £5,000 - £7,000 per year (depending on the company's trading activity), Corporation Tax is typically around £2,000-3,500 and M J Kane & Company accountancy fees have an annual cost of £2,160.

See breakdown below:

Detail	£
Net Income	50,000
Add Vat	10,000
Gross Income	60,000
Less Corporation Tax (Higher End)	3,500
Less Vat Payment (Higher End)	7,000
Take Home	49,500
Accounting Service (£180 per month)	2,160
New Take Home	47,340

Through a limited company a contractor would potentially only stand to lose 5.3% of their net yearly income on tax and accountancy fees.

▪ Breakdown & Option Comparison

Option	Income Loss to tax (%)	Take Home Pay (£)
PAYE loss	26	37,016
Umbrella loss	40	30,012
Limited Company loss	5.3	47,340

Through a limited company a contractor will be able to maximise their take home pay.