

Contracting in the Public Sector: Limited or Umbrella?



Competex Umbrella Ltd





The landscape of contracting in the UK's Public Sector has changed due to HMRC's 'Off-Payroll Working' rules, and, in light of these changes, umbrella company working is now the only viable way forward.



This document is for interim managers, consultants, contractors and other independent professionals affected by the April 2017 HMRC legislation entitled 'Off-Payroll Working in the Public Sector', which has changed the rules for those working through limited companies in the public sector.

In this document, we will explore how those working through limited companies have been affected by the rules, and why the umbrella company option is the most viable way forward for those wishing to work independently in the public sector.

In section 1 we will examine the legislative changes in detail, their effect on limited company workers in the public sector and how working practices have changed.

In section 2, we will explore the umbrella company alternative, and explain in detail why it is now the recommended option for those working on temporary contracts in the public sector.

We hope this short guide proves useful, and as always, if you have any queries or feedback, please do not hesitate to contact our team.

CRS Rules

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Notes on terminology

Limited companies, personal service companies or PSCs are referred to here as 'limited companies'.

Those offering services, such as interim managers, consultants, contractors or independent professionals, are referred to here as 'workers'.

Public sector departments employing or hiring these workers are referred to as 'end-clients'.

Interim providers or recruitment agencies are referred to here as 'agencies'.

Those offering services, such as interim managers, consultants, contractors or independent professionals, are referred to here as 'workers'.

Working in the charity/not-for-profit sector

These rules also apply to certain organisations in the charity/not-for-profit sector, as well as to the public sector. If your end-client is subject to the [Freedom of Information Act \(2000\)](#), these rules will apply.

Working in the private sector

These rules do not apply to the private sector. Limited company working is the recommended way of working for contractors in the private sector and IR35 has not changed for those working in this sector.

It is possible, and recommended, to retain use of your limited company for private sector contracts while also working through an umbrella company for public sector contracts. Competex can handle your tax & compliance across both trading formats.

SECTION 1:

Limited company working in the Public Sector

What are the 'Off-Payroll Working' rules?

Under the 'Off-Payroll Working' rules instated in April 2017, it is now the end-client who is responsible for determining the IR35 status of the contract, whereas previously, the worker was responsible for reviewing his/her own contract and determining its IR35 status.

The expectation is that most public sector temporary contracts will fall inside IR35, with very few exceptions. End-clients will be expected by HMRC to default to IR35 status unless there is very good reason to do otherwise. Of course, there is always the risk that HMRC will investigate those contracts that don't.

How has taxation on IR35 contracts changed?

Until April 2017, the responsibility for administering payroll was always with the limited company. The limited company director could decide each month how much salary to pay, if any. However, under the new rules, the end-client or agency (whichever is paying the limited company) is now required to deduct tax and employee's NI at source (at 20% or 'basic rate' – tax code BR) and to pay this, together with employer's NI on the worker's earnings, to HMRC before paying the net amount to the worker's limited company.

As a result, the worker is considered to be receiving fully taxed income into his/her company, which may then be withdrawn directly into his/her own bank account, without further deductions. However, when this taxed income is paid to the director or employee from his/her limited company, the company must account to HMRC appropriately under PAYE Real Time Information (RTI) regulations at the time of making the payment.

If the limited company is registered for VAT, this will be added to the amount paid by the end-client or agency to the limited company. However, different end-clients and agencies are currently calculating VAT in different ways. Some calculate VAT based on the total gross fee, and others calculate VAT based on the gross fee less employer's NI. To date, HMRC have given no guidance regarding VAT, and in each case legal advice will have been sought by the end-client or agency. The net effect on the limited company is NIL, and there is nothing to be gained in disputing either treatment as every lawyer will maintain that the others are wrong.

What is IR35?

IR35, or the 'Intermediaries Legislation', was introduced in 2000 with the aim of preventing workers from under-paying tax and National Insurance (NI) by providing services through a limited company. IR35 states that if you are doing the sort of work for your end-client that would usually be done by an employee, namely if you are under the 'supervision', 'direction' or 'control' of your end-client, the relationship is effectively one of disguised employment and you will have to pay 'employed' levels of tax and NI on your income.

In the private sector, when working under IR35 through a limited company, 95% of your fee income must be paid as salary, and 5% may be used by the company to cover expenses. This 5% allowance has now been removed for individuals working in the public sector under IR35.

[More on determining your status here.](#)

What are the implications for those working through a limited company?

All of this removes the freedom that limited company owners have enjoyed of being independent of their end-clients and agencies, and managing their own income, expenditure and tax affairs. The rules create complications for the worker regarding end of year tax returns, personal expenses, limited company expenses and negotiation of daily rates.

Tax is deducted at 20% (basic rate – tax code BR) with no account being taken of the personal allowance, unless you make a special effort to arrange with HMRC to have them issue a bespoke tax code. This means that the tax deducted will not be the correct amount for your particular circumstances. You will be required to complete a self-assessment tax return at year-end, and depending on your total income for the year, you might expect to have more tax to pay, and you should be prepared for this.

Since you will no longer receive the 5% allowance formerly available under IR35 (see above), you will have no untaxed funds available from public sector assignments out of which to pay either company expenses (such as accountancy fees) or other allowable expenses of employment (such as IT and marketing costs, and pension contributions).

Depending on the contract you have negotiated, you may also find that you are unable to claim certain bona fide expenses relating to travel and subsistence, in which case your only recourse would be to attempt to claim such expenses in your tax return. Conversely, you may have negotiated for the client to pay the cost of commuting to work (which is no longer an allowable expense) and this may well be paid to you free of tax instead of being taxed at source, in which case this ought to be declared in your tax return.

In the public sector, the daily rate charged by the worker now has to include the employer's NI paid by the end-client or agency. When you are negotiating your daily rate, you should make sure that all parties fully understand what has been agreed. Is your rate inclusive or exclusive of employer's NI? Is your rate inclusive or exclusive of travel expenses? Will commuting expenses be taxed? Is your daily rate sufficient to cover the costs of running your limited company out of taxed income?

SECTION 2:

Umbrella company working in the Public Sector

Why work through an umbrella company?

Although it is still possible to work through a limited company in the public sector, it is evident that the new rules are making this way of working extremely onerous for all concerned and that there are still a number of issues as yet unresolved by HMRC.

As a reaction to the rules, many workers have decided to leave the public sector altogether, but if this is where your experience lies, leaving the public sector could result in you having fewer options for work.

Enter the umbrella company model, which has been in existence for some time but is becoming a more favoured option by all concerned in light of the new changes.

Many public sector end-clients are preferring to work with payroll umbrella companies because they do all the work. They handle the commercial, employment, taxation, and statutory risks associated with the use of freelance workers. Indeed, workers will find that they enjoy more independence from their end-client working through a specialist payroll umbrella company than they would working through a limited company.

Competex handles compliance for both limited company and umbrella company working, and encourages its clients to operate a limited company for any private sector contracts, using the umbrella company for public sector contracts, in order to keep tax affairs as simple and straightforward as possible.

What is an umbrella company?

An umbrella company is a company that employs freelance workers who may work on numerous different assignments, at various locations, either through agencies or directly for end-clients. The umbrella company enters into an employment contract with the worker and a service contract with the end-client or agency.

Umbrella company working differs from limited company working in that the freelance worker does not own shares in the umbrella company and is one of many such workers employed by the company.

How does Competex Umbrella work?

When you work through Competex Umbrella (also known as 'CUL'), you work as an employee of CUL .

Your contract of employment is with Competex Umbrella and not with the end-client or agency. The terms of your contract of employment is largely in line with the terms of any other contract of employment (e.g. disciplinary, health and safety, etc), but with certain differences to take account of the unusual circumstances of an umbrella company.

You negotiate the terms of your contract with the end-client or agency on behalf of CUL, but the resulting contract is between CUL and the end-client or agency. Having negotiated your fee and any arrangement for expenses, you need to advise CUL so that this detail can be incorporated into the contract with the end-client or agency and into your salary payment structure.

At the end of the month (or other agreed period) you need to complete a time sheet setting out the days (or hours) worked and any expenses due, and arrange for this to be signed off by the end-client. The end-client or agency pays CUL, and CUL pays you two working days after receipt of funds from the end-client or agency.

What does my pay structure look like under Competex Umbrella?

Pay Structure

The fees and expenses received by CUL for the work that you undertake on assignment are kept in a ring-fenced 'fund' that is personal to you and devoted entirely to supporting you as one of our 'employees'.

After deducting a small 'margin' to pay our costs (see [our charges](#)) this fund is used to pay:

- Your pension contributions if applicable (paid free of tax);
- Any other expenses, if allowable by HMRC (paid free of tax);
- Employer's NI on your salary, and
- Any other costs of employment that may arise. (e.g. Automatic Enrolment, Apprenticeship Levy)

The entire remainder of the fund is paid to you as salary, on which tax and employee's NI is then deducted.

This salary is calculated in three parts:

- Basic pay for the time worked, calculated at the national minimum wage rate. The use of national minimum wage is an expedient used by all umbrella companies which enables them to comply with all the legislation associated with flexible working. It does not affect the total amount paid to the employee.

- Holiday pay, based on the national minimum wage. As you are an employee with flexible working arrangements, CUL is obliged to pay holiday pay, which may either be retained and paid to you when you are otherwise not working, or it may be 'rolled up' and paid to you month by month based on the number of days worked in the month. Although this method of payment is not particularly favoured by HMRC, CUL's policy is to 'roll up' holiday pay and thus pay you the maximum funds available as early as possible.

- Bonus, which represents the entire remaining balance of all available funds.

Although calculated as described above, the basic pay and bonus are brought together as a single figure referred to as 'pay' on your payslip.

Taxation

Taxation under CUL is essentially the same as in any other employment.

When you move to CUL, you take your main tax code with you (with all your allowances) by means of the P45 procedure. Any ongoing earnings through your limited company are then taxed as a second occupation (normally via a 40% tax code). If you then wish to go back to earning via your limited company, you carry out the reverse process and take your main tax code back to your limited company.

Expenses

As far as claiming expenses from the end-client is concerned, you agree with the end-client as to what expenses they will pay. CUL then charges the end-client or agency and the end-client or agency then pays CUL.

As far as paying expenses to the employee is concerned, the expenses that may be paid free of tax and NI are determined entirely by HMRC regulations. If you have negotiated for the end-client to pay expenses that are not allowed to be paid to you tax-free, then you do not receive them tax-free, but instead the fund available to pay salary is increased accordingly.

[More on claiming expenses here.](#)

About Competex Umbrella

Competex Umbrella Limited is the only umbrella company designed specifically for the interim management market, and is particularly suited to consultants and other senior independent professionals working in the public sector.

With its 20 years working within the interim industry, Competex understands the needs of interims and other independent professionals and offers a payroll umbrella solution that takes account of many of the features of limited company working such as:

- Paying pension contributions
- Claiming reasonable business expenses
- Certain permissible tax planning possibilities
- Insurance for professional indemnity and employer's liability insurance as standard

Many clients of Competex Umbrella also own and maintain a limited company for private sector assignments, and are safe in the knowledge that Competex is able to handle their limited company and umbrella company compliance at the same time.

For more information on working through Competex Umbrella, and whether it is the right option for you, please contact the team on 01737 234567 or at info@competex.co.uk.

www.competex.co.uk/umbrella