

What are umbrella schemes for contractors

Introduction

Contractors are faced with two tried and tested forms of company/payment structure:

1. Umbrella company
2. One person limited company

This article explains the features and benefits of an umbrella company and compares it to using a limited company.

The differences between the two are explained in the article '[Limited Company or Umbrella: Deciding on a Payment Structure.](#)'

What is an Umbrella Company

An umbrella company is in simple terms an outsourcing of your payroll. Rather than having the cost and hassle of setting up your own limited company you can work via an Umbrella Company.

With an umbrella company solution:

- o The contractor would not be a director nor have the responsibilities associated with running a limited company.
- o The umbrella company provider would take care of all accountancy and taxation matters and also deal with all administration matters.
- o The contractor completes a timesheet and forwards it to the umbrella company, who then invoices the agent.
- o Following payment by the agent to the umbrella company, a payment is made by the umbrella company to the contractor.

Since the [Managed Service Company Legislation](#) was introduced in the 2007 Budget there is only one viable choice for an umbrella company, which is the [PAYE Umbrella](#).

A PAYE Umbrella treats all your income as salary. This means you pay employers NI, employees NI and PAYE on all your income.

IR35 Issues

Note that any choice of payment structure (umbrella, limited company etc) does not in any way influence the IR35 status of the contract or modus operandi of the working arrangements. The choice would not influence any HMRC review or decision as to whether the contract falls within the regulations of IR35.

However, operating using a PAYE Umbrella means that all your income will be treated as though you are caught by [IR35](#), regardless of the actual IR35 status of each contract. The [financial impact of IR35 on contractors](#) is considerable, and long term contractors would be wise to invest time avoiding the legislation. You can find out how much it could effect you using the [IR35 Calculator](#).

Advantages and Disadvantages of Umbrellas

Advantages

- o Avoids time and trouble of running a limited company. After a simple set up, the contractor completes timesheets and forwards to the umbrella company.
- o Knowledge that money is lodged into their bank account and documents are sent to them explaining how the payment is calculated. No need to be involved with running a spreadsheet, VAT returns, payroll matters, company accounts, taxation, etc.
- o For short term contractors, a main advantage is not having the costly process of forming a company and then arranging for it to be dissolved.

Disadvantages

- o The contractor will by definition not be running the company and will therefore be using it simply as a service to process transactions.
- o The contractor cannot represent themselves as running their own independent business, through which they can make policy decisions, take risks or act as company director.
- o There is inevitably some delay in the contractor receiving their money, since it needs to pass through a third party account before reaching them. This is down to the efficiency of the umbrella company.

- o There is an element of trust on the part of the contractor, since their money will be passing through the third party umbrella company bank account.
- o For long term contractors whose contracts are outside IR35 umbrellas are not as tax efficient as using a limited company.

Umbrella or Limited Company?

For long term contractors outside IR35 the limited company is the recommended route.

For short term contractors and those inside IR35, the choice is similar to owning a car or using a hire car or taxis/bus service. With car ownership, you are fully responsible for the purchase, running costs and eventual sale of the car (just like your own limited company). It works well as a long term solution where you will need the car for a minimum of one year. Compare this with a holiday situation, where you would hire a car or use taxis - much better for a short term solution where you do not want or need the benefits of ownership and do not wish to be concerned with the running costs of the taxi/bus - you just want a simple solution to get you to your destination (just like an umbrella company would do for you).

This is discussed more in [Limited Company or Umbrella: Deciding on a Payment Structure.](#)

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- o [Choosing an umbrella services company](#)
- o [Moving from a Limited Company to an Umbrella: Reasons and Practicalities.](#)
- o [Joining a Contractor Umbrella Scheme](#)

Related Calculators:

- o [Contractor Umbrella Calculator](#)
- o [Contractor Calculator](#)
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