

## Contracting and the national minimum wage (NMW)

**Limited company contractors** who are directors of their business are typically not impacted by the national minimum wage (NMW) legislation. **Umbrella company contractors** employed by a compliant service provider are affected, and NMW applies.

Contractor directors are potentially excluded by a quirk of the legislation, which only applies to workers and excludes office holders. A directorship of a limited company is an office.

Umbrella company contractors on the other hand should be employed by their service provider and therefore qualify as workers. The situation for umbrella company contractors is made potentially more complex because of expenses and whether contractors are paid between assignments.

### Company directors and the NMW

According to the **National Minimum Wage Act 1998**, the NMW only applies to 'workers', as defined by the legislation. A company directorship is not employment but an 'office', and is excluded by the rules, so NMW does not apply.

For many start-ups and small businesses, not having to pay the company's principal a salary – even at NMW – often ensures the survival of the business, as in the early days there may simply not be enough cash generated to cover NMW salary costs.

Contracting businesses are typically highly cash generative from the outset, so cashflow is less of an issue. However, there are tax and financial advantages to remaining purely as a company officer specifically so that NMW does not apply.

“  
A company directorship is not employment but an 'office', and is excluded by the rules, so NMW does not apply  
”

### Limited company contractor employees

It is possible, although by no means compulsory, for a limited company contractor to be an employee of their own business as well as a director. If they decide to go down this route, and set up an employment contract with their own business, NMW will apply

If NMW applies to a limited company contractor who is both a director and has decided to be employed by their business, there are potential negative **tax and financial implications**. The contractor will almost certainly end-up out of pocket.

This is because, as an employee, the contractor must **pay themselves a salary** at NMW for the hours they work. For most contractors, this would typically be at least 40 hours per week.

If NMW does apply, then the contractor may find themselves having to pay a salary substantially higher than the minimum required to stay below the National Insurance Contributions (NICs) lower earnings limit yet qualify for state pension and benefits. This can mean they pay additional income tax and NICs, without necessarily any additional state pension or benefits advantages.

### What happens if NMW applies but is not being paid?

Because NMW was originally introduced to ensure vulnerable workers do not get exploited by unscrupulous employers, there are steep penalties for failing to comply. HMRC is the organisation responsible for enforcing the rules.

But it is usually an exploited employee who blows the whistle to the authorities: a highly paid contractor is not likely to shop themselves to the taxman. And if they are only a director and not an employee, then NMW does not apply anyway.

However, HMRC could technically take action if the contractor did have an employment contract in place but were not paying themselves NMW. This could result in a fine of up to £5,000 for the contractor's company if the unpaid NMW was significant.

### Umbrella company contractors and the NMW

The situation for umbrella company contractors is both straightforward and complicated. It is straightforward, in that a compliant umbrella company should have a contract of employment with all of its contractor employees, so NMW applies to all umbrella contractors.

But it can become complicated if a contractor finds a service provider who does not provide an employment contract from the outset. That should sound alarm bells, because if the umbrella is not compliant with its contracts, it may not be compliant in other ways.

The situation can be complicated further by the fact that expenses cannot be paid in lieu of NMW. The contractor's basic pay must meet NMW requirements for the hours they have worked, and they should be paid expenses on top. This has traditionally been a common source of non-compliance by

umbrella companies and agencies.

Depending on what type of contract they are on with the umbrella solutions provider, the contractor could continue to receive NMW payments for a limited time [when a contract ends](#) and between assignments.

Published: Wednesday, April 30, 2014

© 2016 All rights reserved. *Reproduction in whole or in part without permission is prohibited. Please see our [copyright notice](#).*



ABCe verified website - last audit confirmed *134,482 monthly unique visitors*

© Copyright 2016 Byte-Vision Limited UK. All rights reserved [Copyright notice](#)