

## Contractor guide to understanding umbrella company payslips

Contractors receiving their first umbrella company payslip can sometimes find it a challenge to understand exactly how their pay has been calculated.

However, according to Chris Futcher, CEO of [The Pulse Umbrella Group](#), payslips provided by compliant umbrella solutions providers will be transparent and straightforward to understand, once contractors know their way around them.

"Contractors are employees of their umbrella company and should receive a payslip exactly the same as when they were permanent employees," says Futcher. "It is the contractor's gross fee income that drives payslip calculations, which should be clear on the statements a contractor receives.

"Underpinning the umbrella company contractor model is the ability to claim legitimate travel and subsistence costs from gross fees, which are reimbursed tax free. As a contractor claims an increasing amount of legitimate expenses, the less income tax and National Insurance Contributions (NICs) they pay."

### Payslips versus 'statements'

As Futcher explains, the vast majority of [Umbrella companies](#) will supply their contractors with two documents: "At the end of each week or month, depending on their invoicing cycle, a contractor will be sent a payslip. This is what they would have received when previously an employee, and is what is sent to HMRC.

"The contractor should also receive a paper or online customer 'statement', which we call the 'payslip breakdown'. This document starts with the contractor's gross fee income, lists all of the deductions, including the umbrella company's fees, Employer's NICs and includes a detailed breakdown of the included expenses."

### The contractor's statement

"Because the contractor's statement, payslip and net pay are driven by what the contractor earns in gross fee income, in order to explain exactly how the figures are derived, it is easier to start with the contractor's statement," suggests Futcher.

He provides an example monthly statement, or gross payslip, of a typical IT contractor on a day rate of £450 working a standard 7.5 hour day five days a week travelling by car from their home in Tenterden, Kent to their client's site in Ashford:

#### Gross Payment Breakdown

Invoice income	8100
Our fee	99
Employers NI	862.28
Salary Sacrifice	0
<b>Gross income for salary</b>	<b>7138.72</b>

#### Invoices and Timesheets

Invoice	Description	Rate	Units	Value
12345	week ending 05/10/12	450	5	2250
12346	week ending 12/10/12	450	5	2250
12347	week ending 19/10/12	450	5	2250
12348	week ending 02/11/12	450	3	1350
<b>Invoice Net Total</b>				<b>8100</b>

#### Expenses

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Chris Futcher, The Pulse Umbrella Group

Date	Description	Amount
01/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
02/10/2012	Sundry expenses	30
02/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
03/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
04/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
05/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
08/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
08/10/2012	Subsistence	9.52
09/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
10/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
11/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
12/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
15/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
16/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
17/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
18/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
19/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
29/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
30/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
31/10/2012	Mileage - 28 miles from Tenterden to Ashford	12.6
<b>Total</b>		<b>266.32</b>

Invoice fee income is what the umbrella company bills the agency or client. It is the contractor's gross fees

'Our fee' is the umbrella company's weekly fee. Another contractor being paid weekly might have their weekly fee deducted instead

Employer National Insurance Contributions (NICs) are deducted from the contractor's gross fee income. This is because, unlike a regular employer, the umbrella company has no other income apart from the gross fee income of its contractor clients

Some contractors may be paying into a private pension from their gross employment income, or paying for childcare vouchers. This line would include such salary sacrifices

Invoices and timesheets show what a contractor has billed for the period. In this case, it is a month's timesheet and invoice, because the contractor is paid monthly

The final section will detail [allowable expenses](#) including travel and subsistence.

Approved expenses are "deducted from the gross contract income and set aside to be reimbursed outside of the payroll calculations," explains Futcher.

"The Employer's NIC calculation is a complex component. In theory, to calculate Employer's NICs it is necessary to know the employee's gross salary," he admits, "but with an umbrella contractor, you can't calculate the gross salary until you know the value of the Employer's NICs." The solution, says Futcher, is a key part of any umbrella company's internal software systems.

## The payslip

The next stage is to work through the contractor employee's monthly payslip, which is driven by the contractor's statement and helps build a picture of where the numbers come from:

## Pay elements

Description	Units	Rate	Total	
Basic Pay	144	6.19	891.36	
Advance Holiday Pay	144	0.7472	107.60	
Commission	1	5873.45	5873.45	
Expenses (non-taxable)	1	266.32	266.32	
<b>Deductions</b>	Payment period weekly			
Total Gross pay	7138.73			
Gross for Tax	6872.41			
PAYE Tax	1905.97			
National Insurance	415.36			
<b>Total due to contractor</b>	<b>4817.38</b>			
Payment reference	Payment Date	Tax Code	Period	NI Number
Example-reference	30/11/2012	647LW1	33	AA9999999A
Employers Tax Reference	999/AA99999	Tax Office Address		HMRC

The payslip numbers are explained as follows:

Basic pay is based on the legal minimum wage multiplied by the number of hours worked. This calculation ensures that the contractor is paid the legal minimum wage before any expenses are deducted. Futcher's view is that this approach is an essential compliance safety net for both contractor and Umbrella.

Employees enjoy a statutory minimum of 28 days leave per year pro rata. A regular employer would continue to pay the employee when they are on holiday, or accrue leave for fixed-term contract or temp workers.

Umbrella company contractors must ultimately fund their own holiday pay from their gross fee income and, instead of accruing holiday pay are typically 'advanced' their holiday entitlement as they go along. Holiday pay is calculated using a standard multiplier of 12.07% of their basic pay

Futcher notes that some umbrella solutions providers deduct holiday and withhold it, rather than 'advancing' it to their contractors: "This practice is fine as long as the contractor takes a holiday or is repaid the money when they leave."

The commission element paid to the contractor is a variable amount and changes according to how much the contractor claims as expenses. Ultimately it is the difference between NMW, holiday pay and expenses.

Total gross pay includes salary, holiday pay and commission. Income tax and the contract's employee NICs are calculated based on the total of all these amounts, less expenses.

PAYE Tax represents income tax deductions via the umbrella company employer's Pay As You Earn (PAYE) scheme, which is paid directly by the contractors umbrella company to HMRC

National Insurance are standard NIC deductions via the umbrella company employer's payroll which are paid directly to HMRC.

"The resulting amount represents the contractor's net pay: £4,817 out of gross fee income of £8,100," says Futcher. "The equivalent amount for an employee unable to claim expenses would be £4705, leaving the average umbrella company contractor financially better off by up to 8% of take-home pay."

## The impact of the Agency Workers Regulations on payslips

Some contractors whose agencies use the [Agency Workers Regulations](#)' Swedish Derogation may see additional deductions in their payslips.

Futcher explains: "The [Swedish Derogation](#) enables agencies to hire contractors so that AWR does not apply. To do this, the worker must be paid for a minimum of four weeks between assignments."

Once again, the only way to fund this model is through the contractor's gross contract income. This means additional deductions will be shown on the contractor's statement, or gross payslip.

Futcher concludes: "Once contractors understand that all the calculations they see on their payslip and umbrella service provider statement are driven by their gross fee income, then it becomes easier to see where the figures come from, and where their money has gone."

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