

## Limited company 'inside IR35' v umbrella PAYE – advantages and disadvantages



The Off-Payroll legislation shifts the responsibility for assessing IR35 status from the contractor to the end-client. Unfortunately, whether it's to mitigate their tax liability risk or negate their compliance requirements, many clients are more inclined to assess their contingent vacancies as 'inside IR35', despite the professional damage that such an approach can cause.

Contractors have little say in the matter. Those that can neither convince their client to conduct a fair assessment nor secure an 'outside IR35' contract elsewhere will have a new dilemma to consider – selecting an operating model to adopt.

There are two primary options – working via a limited company on a Pay As You Earn (PAYE) engagement, and working under an umbrella company. Below, we consider their relative advantages and disadvantages.

### Limited company contractors can contest tax treatment

For contractors seeking to contest a contentious 'inside IR35' status determination, the only option is to continue trading via their limited company. When entering an engagement with an umbrella company, the umbrella officially becomes the contractor's employer, meaning the contractor is foregoing any chance of successfully overturning their deemed status.

Whereas the Off-Payroll legislation's '[client-led status disagreement process](#)' has thrown a spanner in the works, limited company contractors still have means of recourse to secure fair compensation for their engagement.

"The Off-Payroll legislation dispute resolution process heavily disadvantages contractors and largely defeats the purpose due to the fact that it effectively renders the client judge, jury and executioner when considering the appeal," notes Martyn Valentine of [The Law Place](#).

"Nonetheless, a limited company contractor does have the opportunity to make an employment tribunal (ET) claim for the requisite employment rights to accompany their 'deemed for tax purposes' status, providing the duration of the engagement exceeds two years."

Valentine also observes that contractors employed by umbrella companies can bring a claim in the ET if their umbrella has committed an unlawful act. This might include deducting employer's National Insurance Contributions (NICs) from their contract rate, which is in breach of the [Social Security Contributions and Benefits Act 1992](#).

### Will umbrella contractors have more contracts to choose from?

Due to the large portion of hiring firms and agencies circumventing their compliance requirements by inserting an umbrella company into the supply chain, an inevitable benefit of agreeing to take the umbrella route is greater choice of contracts.

During the build-up to the private sector Off-Payroll extension, there were reports of many private sector firms imposing bans on the continued engagement of limited companies, with umbrella companies proving the preferred engagement model for most.

“With an increasing number of firms adopting ‘umbrella-only’ engagement models, it stands to reason that contractors trading flexibly stand to grasp more opportunities,” says [Professional Passport](#) CEO Crawford Temple.

For many engagements, a contractor agreeing to trade via an umbrella company could prove a necessary requirement for placement. Although they are responsible for processing tax on payments made to ‘inside IR35’ contractors, many agencies don’t have payroll systems in place. As such, the imposition of a third party such as an umbrella into the supply chain will be necessary to avoid falling foul of the Off-Payroll legislation.

## **Weighing up the comparative costs of engagement**

The level of post-tax take-home pay is a crucial factor for any contractor. Indications suggest that contingent workers trading via their limited company might be financially better off after all deductions have been made.

“Contractors need to remember that payment received via an umbrella company is subject to two deductions – the agency and umbrella margins,” notes Valentine. “For contractors, the latter is an unnecessary cost, because the services provided by the umbrella should really be provided by the agency.”

Although Temple acknowledges that an umbrella contractor will likely receive a slightly lighter pay packet, he argues that take-home pay remains comparable, while highlighting the value that contractors receive in return for funding the umbrella margin:

“Where an agency advertises a contract for which it doesn’t intend to operate payroll, it will quote an uplifted rate, which is intended to cover all necessary costs on top of the PAYE rate. This includes employment costs and, where an umbrella company is concerned, the umbrella margin.

“In return, the umbrella holds certain liabilities as the contractor’s employer. For example, if the contractor falls ill, they can claim statutory sick pay from the umbrella company which they can’t claim back. So, more than simply for the trouble of processing a payslip, the umbrella company charges a margin in part to compensate for the risk it assumes.”

## **Are limited company contractors less vulnerable to non-compliance?**

A lack of transparency regarding rates can lead many umbrella contractors to believe their pay is being subject to unjust deductions. An agency will typically advertise the contractor’s PAYE rate when engaged directly. But a failure to distinguish between the PAYE rate and the uplifted rate by agencies advertising contracts via umbrella companies has left many contractors feeling substantially short changed.

What agencies often refer to as the ‘[assignment rate](#)’ is often accepted as the PAYE rate by the contractor, who receives significantly less than expected following taxes and umbrella deductions.

“There’s no legal definition of an ‘assignment rate’, despite misleading guidance from HMRC,” highlights Valentine. “Any contractual provision entitling an umbrella to deduct employment costs from the worker’s fee would be declared void by the court and an aggrieved contractor will be entitled to full compensation.”

However, despite being in breach of both the Off-Payroll legislation and the SSCBA, this intentional misrepresentation of contract rates remains prevalent. Consequently, it might be argued that the avoidance of exposure to misrepresented contract rates is another advantage of limited company contracting.

## **Incoming measures to protect agency workers**

Fortunately, the Finance Bill 2020 also introduces a new addition to the Conduct of Employment Agencies and Employment Businesses Regulations 2003 – a legislative requirement for firms to provide workers with a ‘[key information document](#)’ prior to agreeing contractual terms. For a worker paid via an umbrella company, this document should clarify the gross rate, deductions made and expected minimum rate paid to the worker.

However, compliance with this regulation across the sector isn’t guaranteed. This, for Temple, serves to reaffirm the importance of engaging with a demonstrably compliant umbrella company:

“Where a contractor is engaged via an umbrella company, they should not be disadvantaged, compared with were they to be placed on an agency payroll. However, the problem is many payment intermediaries are posing as umbrella companies and undertaking non-compliant practices.

“But it’s easy enough for agencies and contractors to find out whether they are engaging with a trustworthy umbrella company as the reputable firms will be recognised as such by the Employment Agencies Standards Inspectorate and accredited by industry bodies such as Professional Passport. We recommend that contractors carry out such a check should they be asked to work through an umbrella company, to enable them to enjoy the benefits without the risk of non-compliance.”

Valentine encourages contractors wary of entering into an umbrella engagement for the first time to take extra precautions: “Contractors who are concerned about an umbrella company’s contract of employment should seek independent legal advice and remember to never opt-out of the Conduct Regulations for ‘inside IR35’ engagements.”

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