



Contracting Scout's guide
to switching from a
limited company to an
umbrella company

Is it time to make the move?

A woman with curly hair and glasses is sitting at a desk in a bright office, working on a laptop. The desk is cluttered with various items including a potted plant, a pen holder, a coffee cup, and a notebook. The background shows large windows letting in natural light.

An increasing number of contractors are switching from running their own limited company to joining an umbrella company, saving themselves from the hassles associated with being a director and avoiding the risks of IR35.

As this has become an increasingly popular move, we've put together Contracting Scout's guide to making the switch, explaining what it involves, the pros and cons, and whether it's the right move for you in the first place.

Time to switch?

One of main reasons contractors are [switching from operating via a limited company to an umbrella company](#) is the recent reforms to IR35 regulation, which put limited company contractors working in the public sector at a greater risk of paying higher taxes as a result of changes to legislation.

The reforms which took effect in April this year, remove the responsibility for determining the IR35 status of a personal service company (PSC) worker from the individual contractor and instead transfer this role to the public sector authority that hires the contractor.

As a result, many poorly informed public sector bodies and recruitment agencies are being overly cautious when it comes to PSC contractors. Reports show they have been significantly reducing the job prospects available for contractors or simply saying that IR35 applies to all PSC contractors working in the public sector regardless of the particular details of their individual contracts. Whether due to a lack of expertise or the time to accurately determine each contractor's status, we have already witnessed the repercussions,

with organisations such as Transport for London introducing a [blanket ban](#) on limited company contractors.

And, while the government hasn't announced any plans to extend the IR35 reforms to the private sector, contractors are concerned about this possibility and are therefore taking pre-emptive action.

The full background to IR35, including the reasons for the reforms and the steps you can take in response to the changes, is a subject for another guide. Fortunately, we've already prepared one which you can [download here](#).

In this guide, we'll explore the advantages of using an umbrella company – including but not limited to, a means to avoid the headache of IR35 legislation – as well as what you should consider before making the switch and the steps involved.



Scouting the best contract for you

Umbrella contracting 2015 vs 2017



THE AVERAGE ASSIGNMENT RATE HAS INCREASED

73% of workers earn at least £15 per hour, compared to 53% in 2015.



THE AVERAGE LENGTH OF ASSIGNMENT HAS DOUBLED

Employees work 29 weeks per assignment, compared to just 14 weeks in 2015.



EMPLOYMENT LENGTH HAS INCREASED BY OVER 50%

Contractors stay with their umbrella for 46 weeks on average, compared to 30 weeks in 2015.

* Research conducted by the Freelancer and Contractor Services Association (FCSA)

How an umbrella company works

Working through an umbrella company offers an easy transition into contracting work. Unlike a limited company, there's no need to incorporate, register with HMRC or open a business bank account. Instead, you can be up and running within a matter of hours, without any overly complicated paperwork. Instead, there's just an application form or contract for you to check and sign.

Here's how it works:



A contractor enters into a contract with an umbrella company, becoming a Pay As You Earn (PAYE) employee. There's a simple joining process that normally involves filling out a basic application form and signing a contract. There's not typically much else involved and you can usually start billing that same day.



The umbrella company takes on responsibility for invoicing, paperwork, payment processing and aspects of contract negotiation on the contractor's behalf. Removing much of the hassle from contracting, the umbrella company also ensures all tax and national insurance deductions are made.



By joining an umbrella company, you enter the PAYE system used by full-time employees. The umbrella company will also take a small slice of the payment generated by the contractor's services as a fee for their services. All of which means take home pay for umbrella contractors is somewhere between 67% and 76%. A limited company contractor who is operating outside of IR35 can typically retain over 80%.

Pros & cons

The umbrella model won't be for everyone, but there are a number of reasons why it's proving increasingly attractive to a growing number of contractors.

We would always advise speaking to an experienced professional adviser about your individual circumstances, but in the meantime here are some key pros and cons to keep in mind:



EASE

The umbrella model is easier. By being a PAYE employee, the contractor avoids the hassle of filling out paperwork, incorporating a company, registering with HMRC and ensuring all tax, VAT and annual returns are completed. The umbrella company provider takes care of all business administration, they even send out invoices and chase payment, and they're responsible for any dealings with HMRC. Even an experienced contractor is likely to appreciate having the administrative burden of contracting taken off their hands, but for new contractors this is particularly valuable.



SPEED

The umbrella model is simple and quick. A contractor can be up and running and able to start billing the same day they choose to use an umbrella company, which means payments to you can be processed far quicker than if you went down the limited company route.



NO UNCERTAINTY OVER IR35

As we've explained, one of the attractions of the umbrella model is that the contractor will not fall within the scope of IR35. Umbrella companies tax their employees and pay NICs in the standard way so the issues over IR35 do not apply. That means there's no risk of being taxed at a higher rate than expected as a result of the recent reforms. This is particularly useful for contractors who do a lot of work for one client and could find it difficult and time consuming to establish that their status falls outside of IR35.



RECRUITMENT AGENCIES PREFER TO PAY CONTRACTORS WITHOUT HAVING TO ENGAGE THEM DIRECTLY

An umbrella company frees your recruiter from concerns over payments and invoicing and this reduces the costs and administration burden on the recruiter. By using an umbrella company, you don't trouble your recruiter with concerns over payments and invoicing or legislation issues (you have your umbrella company for that) – and they don't incur the costs of employing you.



EMPLOYMENT RIGHTS

Using an umbrella company means you will be entitled to paid sick leave, as well as maternity or paternity pay and pension contributions. By working with an umbrella company that genuinely employs its contractors, you can expect to receive all the benefits offered to full-time employees, while still enjoying the flexibility and variety of contracting. By contrast, limited company contractors receive none of these benefits and face having to pay the same deductions as full time employees if IR35 applies to their engagement. Umbrella company users face no IR35 complications.



PROPER INFRASTRUCTURE AND HR SUPPORT

By working with an umbrella company, you have an established employer who can assist with all employment related issues such as mortgage requests and employment related issues which arise during an assignment.



PAY

Because you are a PAYE employee and the umbrella company takes a small fee from your payment, your take home pay will be lower than if you operated through your own limited company. Umbrella employees typically take home 67–76% of the value of their contract, while limited company contractors who can prove they are not within the scope of IR35 can retain upwards of 80% of their contract after tax.



LESS CONTROL

The counterpoint to greater ease is less control. Some limited company contractors prefer to be in complete control of their financial affairs and accounting for all expenses. Under the umbrella model, they are not in charge and ensuring all payments and deductions are made correctly is the responsibility of the umbrella company.



How you're paid as an umbrella contractor

– and understanding your payslip

Before you take the plunge and switch to using an umbrella company, it's important to understand how you will be paid and how this differs from being paid when contracting via your own limited company.

It's also important – for both financial and legal reasons – that you fully understand information presented on your payslip, which is why working with an established umbrella company is important, as they will ensure all legal obligations are met and all information you receive is clear, accurate and easy to understand.

How clear is your payslip?

QUESTIONS TO ASK:

- Q. Can you clearly interpret all information, including expenses, the contributions and taxes deducted and see how this relates to the amount you've been paid?
- Q. Did you report your expenses yourself and do you recognise them all?
- Q. Can you see your NI contributions and tax rate clearly?
- Q. Are fees correct and openly reported?

Using an umbrella company means your income is subject to PAYE and National Insurance contributions. You can also claim certain types of expenses, which are reimbursed tax free, instead of paying yourself this amount as a salary.

This differs from the limited company approach, where you become a director and shareholder and typically pay yourself a low salary and the balance as dividends. As noted, this means extra paperwork and this does carry an additional administration burden and IR35 concerns.

Other money matters

EXPENSES

There are certain types of expenses that contractors working through an umbrella company can claim and be reimbursed for. However, the number of contractors able to claim expenses was reduced following regulation changes introduced in April 2016.

The change in rules came about because HMRC argued that most contractors working through umbrella companies were treated the same as full-time employees, but since full-time employees were unable to claim tax relief on travel and subsistence, contractors shouldn't be able to either.

As a result, contractors must demonstrate they are being treated differently to full-time staff in order to claim these costs.

HMRC states that in order to claim expenses, contractors must demonstrate they are not under supervision, direction or control (SDC). This means they are not monitored at their place of work, and

not given assistance or dictated to when completing their duties.

Contractors able to prove they are not subject to supervision, direction and control can claim both travel and subsistence expenses. For travel expenses, it's likely a limit would be agreed in advance, and these would cover travel to carry out agreed requirements of an assignment – excluding commuting – as well as travel to and from a temporary place of work.

For subsistence expenses, there is again likely to be an agreed limit with your client. These include expenses that could typically arise during a business trip, such as food, drink and accommodation.

INSURANCE

While limited company contractors need to take out their own insurance, one of the benefits of joining an umbrella company is that insurance is already taken care of.

Typically, you'll be provided with professional indemnity insurance, which offers protection if your client seeks compensation for a mistake or negligence on your part. You'll also receive public liability insurance, which provides cover if you cause injury or other loss to a member of the public or a member of staff.

MORTGAGES

As mentioned, one of the benefits of the umbrella model is you have access to support for employment issues such as assistance with mortgage reference requests.

However, gaining a mortgage is more complicated when contracting – whether you're a limited company contractor or working via an umbrella company.

Because of this, it's far better to work with mortgage advisers who are [specialists in working with contractors](#) and understand their specific challenges.

Closing your limited company down

If you've read our guide, evaluated your options and decided that you want to stop using your limited company and move to an umbrella company, you have a couple of options.

Typically, contractors will either make their company dormant or close it down.

MAKING A COMPANY DORMANT

The best option for someone unsure about their long term career goals or who would like to keep their options open, is to register their limited company as dormant. The business will continue to exist in the background, rather than being closed completely. This means you can avoid closing fees, as well as costs if you start the business again.

A dormant limited company must have "no significant transactions" during a dormant period.

During this time, the only transactions the company can make are payments for shares, fees paid to the Registrar of Companies and the settling of any civil penalties.

Making a company dormant involves informing the Corporation Tax office and your clients that you plan to cease trading. Then you can chase any outstanding invoices and prepare final accounts to the financial year-end. You must also close business bank accounts, particularly if they accrue interest, wind up payroll by notifying the tax office and terminate contracts with suppliers, such as your phone and broadband provider if they are held in your company's name.

CLOSING YOUR LIMITED COMPANY

Closing a limited company involves setting a closing date and ensuring any outstanding transactions are completed before this time.

It's then a case of informing HRMC, de-registering from VAT and running a final payroll to receive a P45. You should also prepare final company accounts and calculate your Corporation Tax, before paying this to HMRC.

Remaining profits can usually be taken as a last dividend payment, although you should seek expert advice to ensure this is tax efficient.

Finally, you should submit a DS01 form to Companies House, which will cause the dissolution of your company to be advertised to ensure no one objects. This final stage usually takes around three months.

Finding a trusted umbrella company

Once you've made an informed decision about switching to an umbrella company and you know the process to go about closing down a limited company or making it dormant, the final stage is to ensure you work with an umbrella company that is well established and offers exceptional customer service.

Here's where Contracting Scout comes in. We only work with umbrella companies that have received outstanding feedback from clients and are renowned for their accuracy and service.

Once we have a complete understanding of your circumstances and your options, we can put you in touch with the right umbrella solution, [click here to get started](#).

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