

Working and Paying Tax in the UK

Working in the UK?

Then you are subject to UK tax; a simple yet inescapable fact.. There are, however, ways of becoming more tax efficient..

Contracting or freelancing in the UK?

You should seriously consider your options. Tax burdens can be **significantly** reduced thus maximising your finances. To do this you must first determine the way you are going to be paid. There are two main options; Employed (Pay as You Earn or PAYE) or Self-Employed (Self-Assessment).

EMPLOYED

The most common taxation status in the UK is the PAYE taxation scheme (regardless of whether you are originally from overseas or a UK national). PAYE simply means your income tax and NI is deducted by your employer before you receive your pay. The employer is responsible for paying your income tax and essentially controls you. Every tax payer in the UK enjoys a personal allowance (an amount before tax is due) of £6,035. Annual earnings of less than £34,800 are subject to 22% tax and earnings above £34,800 are subject to 40% tax (remember your personal allowance). Under the PAYE system you are also liable for national insurance (NI) contributions.

Permanent employees working on a long-term basis have the least flexibility in terms reducing their tax burden. Tax is paid at source (PAYE) and you may be eligible for a tax refund. Should you wish to claim a tax refund you must keep the P45 form (issued when you complete a job) and a P60 form (issued at the end of the tax year).

So if you require a PAYE status what are your options?

1) Work for a Company directly

Permanent and long-term employees will almost certainly work for a company directly.

Benefits:

Employer assumes responsibility for paying your tax on your behalf, so you don't need to worry about it.

You hold employment rights such as entitlement to sick pay, holiday pay etc.

Costs:

Employer takes control.

Least tax efficient option; the tax deducted from you is unlikely to maximise your salary.

2) Set up your own Limited Company

Benefits:

You keep control of your finances.

Tax efficient; efficient expense management and tax planning leading to may reduce tax paid. and use of dividend payments that that attract a reduced tax rate with planning.

Costs:

Administrative hassle associated with running your own company; you are responsible for all reporting aspects together with carrying out your day job!

It is often advisable to hire an accountant.

3) Use an Umbrella Company

Benefits:

Retain control of your finances.

Administrative burden is removed; someone else does the reporting for you.

Tax efficient; the tax you pay may be significantly minimised.

Cost: Charge a fee for their services (often less than a full service of an accountant).

However if you prefer “self-assessment” on a personal basis?

SELF-EMPLOYED

Self-employed workers are taxed through a ‘Self-Assessment’ route. You have an obligation to file your own tax return each year. You also pay NI contributions (but at a lower rate than employed workers), and are allowed to claim expenses, that are wholly & exclusively for your trade.

Self-employed workers often negotiate higher salaries than their permanent counterparts; this is because the “employer/end-client” has fewer direct costs and less responsibility! You also retain freedom and control over personal finance and career issues. On the downside there is less security and you aren’t entitled to the range of benefits (maternity pay etc) that employed workers are entitled to claim. The combination of these facts together with the current credit crisis means many employers prefer hiring self-employed workers.

A word of caution; the UK tax authorities take a stringent view of “disguised employment” and have introduced something called IR35. This legislation is aimed at self-employed workers operating through service companies. Make sure your self-employed contracts are IR35 compliant.

Conclusion

Working directly as a permanent employee is pretty straight forward as the company bears all the responsibility. However, ‘contracting’ or ‘freelancing’ with an end client or company is not as clear cut; you have greater responsibility for your tax matters which simultaneously opens up more options. There are choices and decisions to make. Good luck.