

## UK income tax system – an overview

The tax year in the UK runs from April to March.

The UK uses a “Pay As You Earn” (PAYE) taxation system. As the name suggests, tax gets paid each week throughout the tax year, whenever earnings are above the tax-free threshold.

### Tax codes explained

For most people, their tax free threshold is the standard one set each year by the UK Government. In some cases however the tax office (HMRC) may set a different threshold, for example if you have other earnings.

The tax free threshold is set by your tax code. The standard tax code for the current tax year is 1060L, which equates to £10,600 tax free allowance (in most cases, you add a zero to the code for the tax free allowance).

Under PAYE, your tax free allowance is applied equally during each week of the tax year (i.e. £10,600.00 / 52 weeks = £203.85 tax free per payroll). Everything above the tax free amount is subject to tax.

*EXAMPLE:*

- *Gross earnings £500 for the week, tax code 1060L*
- *Gross pay less tax free allowance equals taxable pay (£500 - £203.85 = £296.15)*
- *Tax is payable on £296.15*

### Tax rates explained

In most cases tax is charged at a standard 20% - so, in the above example, tax of (£296.15 x 20% =) £59.23 would be payable. However if taxable pay is above the basic rate threshold, higher rates apply.

**(PLEASE NOTE:** these examples simply explain how tax is calculated. In practice your gross pay will be reduced by holiday pay transferred each week to your holiday fund – this is taxed when you draw it from your fund.)

*EXAMPLE:*

- *Gross earnings £1,000 for the week, tax code 1060L*
- *Gross pay less tax free allowance equals taxable pay (£1,000 - £203.85 =) £796.15*
- *Tax is payable on £796.15*
- *Basic rate tax @: 20% on first £611.25 = £122.25*
- *Higher rate tax @ 40% payable on balance (£796.15 less £611.25 = £184.90 @40% =) £73.96*
- *Total tax (£122.25 + £73.96 =) £196.21*

### Cumulative / Week One tax

Whatever your tax code, there are two different ways it will be applied - CUMULATIVE or WEEK 1 BASIS.

CUMULATIVE means your current employer’s pay record contains all your current year earnings and tax data - your “cumulative earnings” – and he/she can therefore calculate tax cumulatively each week for the whole year to date.

WEEK 1 means your current employer doesn’t have the whole picture, so needs to calculate tax using only the data for that individual week.

Depending on individual circumstances this may or may not have an impact on the amount of tax paid over the whole year. The main difference is that on a Week One basis you may lose some tax free allowance if you are

away from the workplace for a time.

As a general rule, it is better to be taxed on a cumulative basis wherever possible.

## **Beware two common tax pitfalls...**

**MORE THAN ONE JOB?** If you are employed by more than one agency/have more than one job – please check you are receiving only the correct tax free allowance, to avoid ending the year with a liability for unpaid tax.

**FIRST JOB SINCE APRIL?** If you start work (or arrive in the UK) during a tax year, you may find that you go for a period without paying any tax at all. Under the cumulative system, this is because each week's tax free allowance accumulates while you're not working. Keep an eye on your payslips. After a while your backlog of unused tax free allowance will get used up, and tax will start being taken. It pays to plan your budget before this happens.

## **Tax paperwork explained**

Cumulative pay and tax details during a tax year are passed from employer to employer via a P45 tax form. When leaving an employer, request your P45 and pass it to your new employer.

If you don't have a P45 from previous employment in the current tax year, or for some reason your P45 doesn't hold all your cumulative pay and tax details, it may be a good idea to talk to the tax office (see contact details below) and see if they can help get your cumulative information restored.

If you register for work with Gordon Yates and don't have a P45 from your previous employment, either because your P45 is missing, or being kept with another employer, or because this is your first UK job since April, we will ask you to complete a P46 tax form. This form ensures you are put on the right tax code.

If we don't have a P45 or a P46, we have to apply a BR (Basic Rate) tax code. This code taxes all your weekly income, without any tax-free allowance.

National Insurance (NI) is a further statutory deduction. NI is always calculated on a Week One basis. In the current tax year, the NI rate is 12% on all earnings between £155 and £815 a week.

## **Tax and the law**

Under PAYE, each UK employer is effectively a tax collector on behalf of the UK government and must adhere to HMRC rules and regulations or face penalties and fines.

We try hard to get your tax right - for your sake, but also because we the law requires us to.

## **Useful contact details**

If you have any queries with tax please call HMRC on 0300 200 3300 and quote your NI number and the Gordon Yates tax reference number: 951 F968WW, or visit: [www.hmrc.gov.uk](http://www.hmrc.gov.uk)

If you are calling about another employment, you will need that employer's tax reference. This should be on your payslip or on the P45 you received from them when you left.

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## Temping through an umbrella company/your own limited company

Umbrella companies act as intermediaries between temps and their agencies.

The good news is they can save a bit of tax and you don't need to handle any of the tax paperwork. The bad news is: a) under £25K a year or so, the tax savings tend to be pretty small or even non-existent; b) the umbrella company charges for the service, and this can eat up some or all of the tax saving; c) they introduce an extra link in the chain between you and your agency so you wait a few days more before getting paid and may also face extra complications if problems of any kind arise.

Having your own limited company means you invoice your agency rather than getting taxed as an employee. This can potentially save more tax than an umbrella arrangement. However it does mean having to register with Companies House and file annual returns. You also need to register with HMRC and file company tax returns and your own employment tax return. If earnings are high enough VAT registration may also apply. Failure to comply with requirements can lead to large fines and penalties. As with umbrella arrangements, the costs tend to outweigh the benefits unless earnings are well over £25K a year.

## Our policy on temping via an umbrella company/your own limited company

We are here to support you, whatever your preferred approach. The vast majority of our temps in fact choose to work directly rather than via an umbrella or limited company. Our systems are geared to handle this, so weekly pay and UK employment tax can be dealt with quickly and simply. If problems arise, all the information is at our fingertips.

Temps who choose to work via an intermediary, whether umbrella or limited company, are costlier for us to administer. However this extra cost is offset because we save employers National Insurance when temps work via an intermediary.

What follows is our personal view.

Gordon Yates has been in the employment business a long time. A few years ago, limited companies were the thing. No-one had really heard of umbrella companies. Then in 2000 the UK government introduced regulations (IR35) designed to restrict what the tax authorities call "disguised employment". As a result it became much harder for employees (and temps) to work via their own limited company. Gradually, umbrella companies became the new thing instead. For the most part, their business model relies on claiming alleged travel and subsistence allowances and then substituting these for pay in order to save tax. In practice however the tax savings are often too small to cover the umbrella company's own charges. So umbrella companies tend always to want agencies like Gordon Yates to add to the pot by paying over the National Insurance saving referred to above.

We have never done this and never will. The first reason is cost: it costs us more to set up, to process and to manage pay via an intermediary. The second reason is risk: we were wary of limited companies before IR35 came in, and see a similar political climate today against umbrella companies. The final reason is service: some umbrella companies are excellent at communicating, others less so. We hate to see our temps messed about.

We think our temps get the safest, simplest and best service by working with us direct. As we said above though, the choice is yours. Whatever you decide we promise our best support.