



**Contracting - the basics**

**Sipher**  
**Accounting & Tax**  
Chartered Certified Accountants and Business Advisers

## Contracting - the basics

**You are a contractor who is thinking of moving from permanent job to self-employment. Straight away you can see that you will be paid a better rate. But is it worth it?**

**Keep reading to find out...**

### How much can I earn?

There are numerous specialists within the contracting community – from IT and management consultants to engineers and locum doctors. Typically, the average rate of a contractor is over £300 per day, depending on where you are located geographically.

In most cases, take-home pay will usually equate to 70-80% of the contract's value once VAT, corporation tax, accountancy fees and other expenditure associated with a limited company has been taken into consideration.

### Case study example

The primary benefit of becoming a contractor is flexibility around working hours, place of work and a feeling of achievement.

As an example we are introducing you to Adam. Adam is a freelancer IT consultant who works for a local bank. He is currently earning £60,000 in a year.

#### Daily rate

In a normal year there are 230 working days thus Adam's daily rate comes to £260 per day.

Adam has now been offered a new role where he will be paid £300 per day. Shall he take the job or stay at his current position?

#### Net income

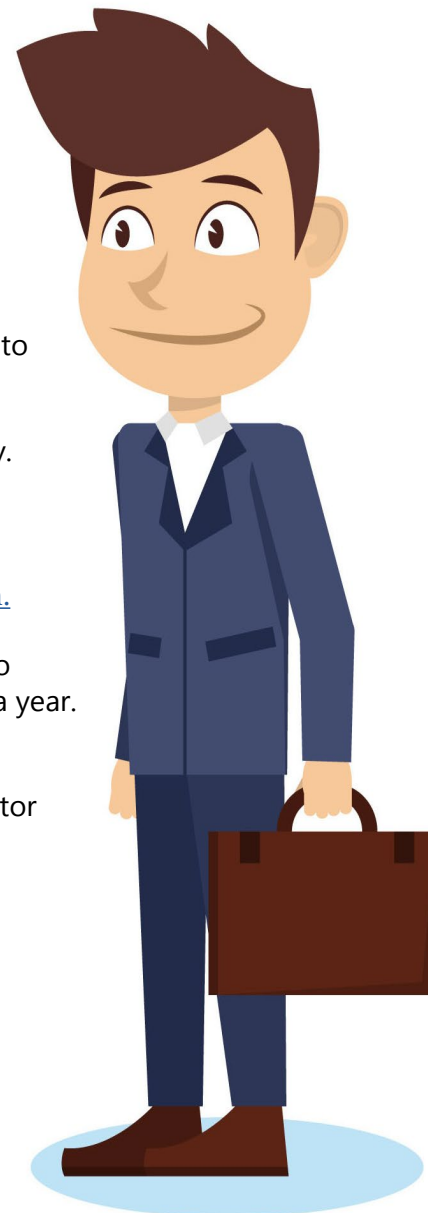
We can quickly check his net income by going to [www.listentotaxman.com](http://www.listentotaxman.com).

His gross earnings from his company 'Adam Consultancy Limited' comes to £69,000 (£300 daily x 230 days). Let's make his profit and loss account for a year.

#### Assumptions

We will assume that for this assignment he is outside IR35 and a sole director and a shareholder. The name of the company is not real.

For more information on IR35, please read our 'IR35 essential read'.





Adam Consulting Ltd	
Profit and loss account for a year	
	£
Income	69,000
Salary	12,570
Accountancy fees	960
Use of home	312
Travelling and subsistence	3,500
Miscellaneous expenses	2,000
Profit - expenses	49,658
Tax @ 19%	9,435
Remaining profit for distribution	40,223

As you can see from the above calculation, Adam Consulting Ltd earned £69,000 during the above year end. He paid himself a salary of £12,570 which can be deducted from Gross earnings for the company. Similarly we can deduct expenses like Accountancy fees, Use of home, Travelling and subsistence and Misc expenses like telephone and mobile bill and other Printing, postage and computer related costs.

The accumulated total of expenses comes to £19,342 which is deducted from total earnings to come at Profit figure. The corporation tax rate form companies with profit under £250k is 19% for 2022/23 onwards. Adam Consulting Ltd will be paying £9,435 of corporation tax. This can be paid 9 months and 1 day after the year end.

This leaves us with £40,223 of undistributed reserves or profit figure which can be distributed among shareholders. We can either distribute all of this profit or choose to distribute some of it. In our example we will only be distributing £37,430 to take advantage of basic rate band.

The total earnings for Adam will be the salary and dividends taken in the year. This comes to £50,000. Adam will show these earnings in his tax return for 2022/23 and will be paying tax on the untaxed dividends income which is calculated as per below.

Adam take home pay calculation		
	PAYE	Company
	£	£
Salary	60,000	12,570
Dividends	-	37,430
Tax on payroll	11,428	-
Employee NIC' s payable	4,994	-
Personal tax due	-	2,657
Corporation tax payable	-	9,435
Total taxes payable	16,422	12,092
Difference	-	4,330
Net salary / take home pay	43,578	47,343
Daily rate	260	300

As you may see from the above example that if Adam takes the contracting route, he will be better off by £4,330 for the year 2022/23. Not only he will be paying less tax his take-home income has also increased by £3,765 to £47,343.

The above calculation are correct for 2022/23 and is a very simple example of Adam's take-home pay. If you would like us to calculate your tax-savings and take-home pay, please get in touch

### Prerequisite of contracting

#### a. Consider IR35 implications

Review your initial contract to assess its IR35 implications. IR35 is the short name used for the 'intermediaries legislation', which is a set of tax rules that apply to you if you work for a client through an intermediary – which can be a limited company or "personal service company" which is how many contractors operate.

If you are caught within the legislation then you can expect to pay about 25% more in tax every year, so you want to try and ensure that it does not apply to you!

Sipher Accounting & Tax can assist you in getting your contract checked by a professional for your peace of mind. Please contact us for assistance.

#### b. Public sector employees

Would you be working for a public sector. The underlying IR35 rules are not changing, but the responsibility for determining whether they apply will shift from the contractor to the public sector end client. So, in the public sector only, the hiring organisation will determine the IR35 status of an engagement. If it decides IR35 does apply, the contractor business will be taxed at source, through the Real Time Information (RTI) system, exactly as if it were an employee.

#### c. Company bank account

If you are forming a limited company with us then Barclays within a couple of days. We will send information which you are required to take it with the bank manager. You are more than with any bank or building society. Please free banking and bank charges.

you will be contacted by you the company setup with you on your meeting welcome to open a bank make your decision on

#### d. Consider PAYE registration

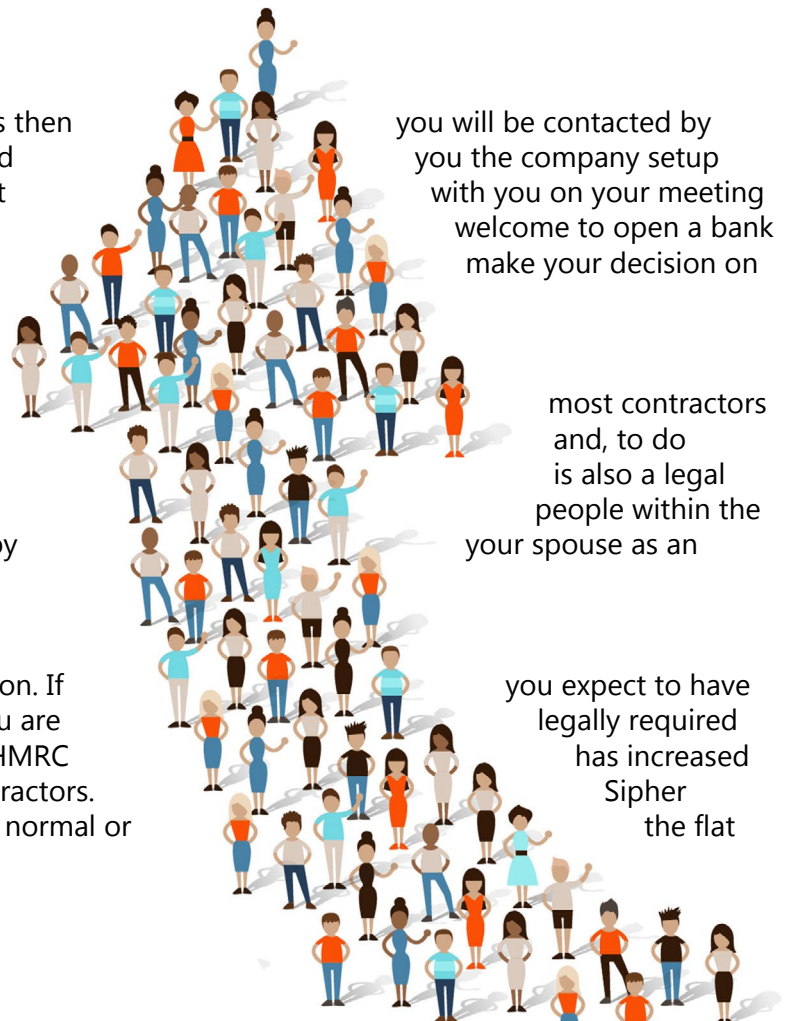
Sipher accounting & Tax recommends take a salary from their limited company that, you need to be PAYE registered. It requirement if you intend to employ other business – for example, if you want to employ administrator for your company.

most contractors and, to do is also a legal people within the your spouse as an

#### e. VAT registration

Investigate the implications of VAT registration. If a turnover greater than £85,000 per year, you are to register for VAT. Since 6th of April 2017, HMRC the flat rate to 16.5% for almost 99% of contractors. Accounting & Tax can advise you to join the normal or rate scheme.

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## Why contracting?

### Advantages

Working as a Contractor offers a number of benefits including:

#### **Rates:**

Due to the relatively short term nature of the position, Contractors will be paid a premium rate. A Contractor's pay is often set by a project management team who are aware of hefty penalties they might face if their project is not completed in time. In addition, Contractors are paid for every hour they work a result in most instances being overtime opportunities.

#### **Work and Skills Variety:**

Working as a contractor creates the ability to work in range of different industries and company structures. Also, working in variety of contract positions is an excellent way to learn and build a unique skill sets. This will not only enhance the Contractor's CV but will allow a greater range of opportunities in different marketplaces.

Contractors are commonly used a resource in many industries, particularly Information Technology, Engineering and Construction. Temporary workers are used in all areas of business.

#### **Notice Period:**

Contractors are not normally tied to the same period of notice as permanent staff. Permanent staff normally have to give at least a month's notice whereas Contractors have the freedom to move around more quickly. Commonly Contractors or Temps move at a weeks notice, but this depends on the needs of each project and the agreement made with the client.

### Conclusion:

Contracting is not for everyone. However those who do choose to contract generally enjoy the varied work, the flexibility and the aspect of meeting new people that it offers them on a daily and weekly basis. Also the prospect of working for themselves and being able to choose when and where they want to work has advantages over the constraints of permanent employment not to mention the financial benefits contractor rates can bring.

### Disadvantages

Contracting is not for everyone and there are some disadvantages to consider before deciding to commit to contracting:

#### **Location:**

Often contractors need to be prepared to travel in order to get the best rates and the most interesting contract so it is not always ideal for those with family ties. It sometimes involves working away from home for prolong periods.

#### **Training:**

Some organisations can be unwilling to train temporary staff. This can mean Contractors have to fund their own training and are responsible for maintaining their own accreditations, where applicable.

#### **Keeping in work:**

For the majority of Contractors it is important that there is good contract continuity. A close relationship with your end client together with a strong CV will always help you to find new roles easily.

## **Formation of a Limited Company**

Sipher Accounting & Tax will form a limited company for you on your request. The process of forming a limited company is quite straight forward and quick. It normally takes a day for us to form a limited company.

### **Limited company name**

Your new limited company should have a unique name. We recommend that you choose a name by visiting <https://www.gov.uk/get-information-about-a-company>. Press 'Start now' and then search your new company name. If the companies house does not show you the results then most probably the name is available.

### **Adding shareholders**

As per the companies law 2006 a single person can open a company. He can be a director and a shareholder of the company. There is no requirement to add a secretary or an extra shareholder.

However if you would like to share your profits with your husband/wife then you can add them as shareholders in the company. The shareholding can be 50:50 or any other ratio which you choose. To add a shareholder you can add their details on our application form. Alternately if you are adding a shareholder after the formation of your limited company then email us their first name, last name and date of birth together with the shareholding percentage you would like to share with them and we can add them in.

Please note that from 6th of April 2018, the first £2,000 (2017/18: £5000) of dividend income is not taxed if it falls within your basic rate threshold.

## **Taking money out of your limited company**

### **Caution**

The monies received in company bank is not your money. The money belongs to the company and if you will withdraw all the funds then it can be treated as a loan and you will be paying a separate corporation tax on the overdrawn loan account.

## **How to withdraw company funds**

There are several ways to take money out of your limited company. You will be acting as a director or as an employee of your company.

### **Salary**

On top of being a director and a shareholder you can also be an employee of the business. Being an employee you can withdraw a salary. Sipher Accounting & tax will advise you how much to withdraw as a salary.

If your husband/wife works for the company then you can pay them a salary too.

### **Dividends**

The dividends are paid out of profits. The company has to be in a profit to pay the dividends. If you are taking dividends out of the company and the company is in loss then you are breaking the law. Sipher Accounting & Tax can advise you on your monthly or yearly dividends figure.

### **Expenses**

If you go out and spend money on company' s business then you can be reimbursed from the company.

### **Loan**

The company is a separate legal entity and whatever transactions happen between you and your

company has consequences. If you withdraw all the money from the business account then it can be treated as a loan. The consequences are as follows:

Loan amount	Condition	Consequence
Less than £10,000	Loan to be paid back within 9 months of the end of company's year end	If the loan is not repaid within the stipulated time period the company will be paying 32.5% tax on the unpaid director's loan.
More than £10,000	The loan is regarded as P11d benefit and should be included in year end P11d calculations. However if the director can pay interest back to the company then the company should not report this on P11d.	If the loan is not repaid within the stipulated time period the company will be paying 32.5% tax on the unpaid director's loan.

### Allowable expenses

The expenses incurred wholly and exclusively for the purposes of your profession are allowable. Sipher Accounting & Tax would advise you to go through with us if you are not sure that it is allowed or would be disallowed. The list of allowable expenses is as follows:

- Travel costs.
- Mileage.
- Accommodation and subsistence (only when staying away from home).
- Business insurance.
- Computer equipment.
- IT software and consumable.
- Telephone and internet.
- Printing and stationery.
- Accountancy.
- Postage.
- Salaries.
- Pension contributions.
- Professional subscriptions.

Please read our full guide on expenses.

### VAT

It is compulsory for a UK business making taxable supplies to be VAT registered if:

- the actual turnover of the business in the previous 12 months is over £85,000; or
- the turnover in next 30 days will be over £85,000.

If your turnover is below £85,000 and you would like to be VAT registered then you can, as a Limited company, apply for voluntary VAT registration. Under the voluntary VAT registration you can choose the date you would like to be VAT registered from.

Please read our full guide on VAT.

## If you're looking for a contractor accountant, then Sipher Accounting & Tax has an offering designed just for you

For a fixed monthly fee of just £100 a month, your dedicated, UK-based Sipher Accounting & Tax accountant will do the following:

- Free of cost pre set-up advice
- Free company formation with 24 hour turnaround
- Free VAT registration
- Free PAYE registration

### Tax and Compliance

We will prepare and submit your:

- Quarterly VAT returns
- Annual statutory financial statement
- Corporation tax return
- Director's Self-Assessment Tax Return for up to two directors
- Companies House Annual Return – Additional annual charge £13

### Payroll and Workplace pension

- Processing the monthly payroll reports for up to two employees
- P11D

### Bookkeeping

- Access to Quickbooks
- Quarterly review of your bookkeeping file

### References

- One free reference per year

### Additional Add-on Services

- All your bookkeeping done for you
- IR35 contract review
- Company Secretarial Service
- Additional references
- Workplace pension compliance and reporting
- Company closure
- Accounts within first 3 months of year end

**0207-490-5470 | [www.sipheraccounting.com](http://www.sipheraccounting.com)**

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