

# CONTRACTORS & FREELANCERS INFORMATION PACK

## Introduction

Welcome to Tax Compute Accounting. Our aim is to help Contractors and Freelancers maximise their take home pay by making the right decision as to their trading status. Whether to use an umbrella company, go limited or simply act as a sole trader. This information pack will help give you all the information you need to make the right decision and we are on hand to offer free advice to guide you through the process. We are a family run business and pride ourselves on being at the forefront of providing the very best customer service to Contractors and Freelancers.

If you are about to go into consultancy then please read this free contractor's guide and contact us for a free consultation. We can offer a premium accountancy service at very competitive rates. Our research shows that the average monthly fees for an umbrella company are between £100 to £120/month plus VAT. Our full accountancy package for a limited company is just £80/month plus VAT. Limited companies have considerably more financial advantages than using an umbrella company.

If you are also already a Contractor and are thinking of changing your accountant then please contact us. Changing accountants is very easy and we will organise all the administration.

We hope you find the information pack useful and we at Tax Compute Accounting wish you all the best in your future career.

Kind Regards

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## **STARTING UP AS A CONTRACTOR**

### **UK contractor numbers continue to rise**

Many more people are opting to become their own boss, according to new research.

A study produced by Kingston University and commissioned by the Association of Independent Professionals and the Self-Employed (IPSE) has concluded that there are now more than 1.88 million freelancers and contractors in the UK.

In particular, there has been a strong increase in the number of female professionals who are looking to start their own successful business, with a 41.2 per cent rise in numbers since 2008, compared to 30.5 per cent growth in the number of males.

### **What is a Contractor?**

Contractors are basically self-employed. Contractors will work for more than one client over a period of time. For example a Contractor may work for Client 1 for the 1<sup>st</sup> half of the year and Client 2 for the 2<sup>nd</sup> half and Client 3 for part of the next year and so on. They are usually paid hourly or daily and they generally earn a higher rate than permanent employees but will receive fewer employment benefits. It is worth mentioning that before individuals leave permanent employment to become Contractors they should consider all the pros and cons and make an informed decision.

### **Why become a Contractor**

Individuals who choose to become Contractors have several reasons for doing so. The two main reasons are greater earnings capability and the benefits of being your own boss. Additionally Contractors gain more varied experience thus enhancing their CV and future marketability.

### **Advantages & Disadvantages**

The advantages are:

- Greater flexibility and freedom over when and where you work

- Increase in earnings
- Tax benefits
- Gaining greater experience and building a network of contacts
- Companies prefer to employ Contractors on short term contracts

The disadvantages are:

- No employment security and uncertainty during downside and recession
- No holiday pay and employee benefits
- Greater administration burden in record keeping and retention
- Responsibilities and increased stress in running a business

## **UNDERSTANDING IR35**

### **What is IR35?**

In a nutshell IR35 is a piece of legislation designed to prevent contractors from acting as 'disguised employees'. Tax Compute Accounting will conduct an IR35 review and ensure that your business is compliant with IR35 legislation and you are acting within the legal framework. Our review will ensure that you are trading legally and correctly as a contractor or freelancer.

### **Are you caught by IR35?**

The first and most important point is to establish whether you are 'employed' or 'self-employed' under HMRC's rules. Essentially the question is whether the contract under HMRC rules is classed as an employment contract. There are basic tests to determine whether the contract is one of employment or not and this will determine whether the Contractor is self-employed or employed. A Contractor will be outside IR35 if he/she can show that:

- Control – You control how the work is done and how it is completed. It is important that a contractor can demonstrate a certain amount of autonomy in the way they undertake a project.
- Substitution – Other suitably qualified contractors or sub-contractors can take over the work from you. The right to provide a substitute in a contractual agreement is an important factor when demonstrating to HMRC

that the contract falls outside the scope of IR35. However, you should still retain the risk and control.

- Mutuality of obligations – Outlining the obligations of Client and Contractor to ensure that there is no obligation for further work when the contract ends. (This would normally be the case for an employee). The contract needs to state a clear end date or termination of the contract based on the completion of the project or works.

## **DECIDING ON YOUR CONTRACTOR STATUS**

When you decide to become a contractor you will need to consider what will be your trading status. Are you going to use an umbrella company, form a limited company, work through an employment agency or simply act as a sole trader? Your individual circumstances, IR35 status and your annual remuneration will be major factors in making that decision. The overriding factors will be which one gives you the greater financial benefit and least administrative burden. A cost versus benefit analysis will help make that decision, taking into account all the relevant issues. Make sure that you receive sound advice from a suitably qualified accountant before making your decision.

### **Umbrella Company**

An umbrella company is a company that acts as an employer to contractors who work under a fixed term contract assignment. The umbrella company will be responsible for billing and collecting payment from the client. They in turn will pay the contractor the agreed salary net of payroll tax, NI and the agreed management fee.

Umbrella companies have become more prevalent in the UK since the introduction of IR35 legislation and it is estimated that 14% of the UK's professional contractors are currently managing their business by working through an umbrella company.

### **Limited Company**

HMRC defines a limited company as an organisation that you can set up to run your business - it's responsible in its own right for everything it does and its finances are separate to your personal finances.

Any profit it makes is owned by the company, after it pays Corporation Tax. The company can then share its profits.

### **Sole Trader**

The simplest method of contracting as your own boss. As a sole trader, you run your own business as an individual and you keep all your business's profits after you've paid tax on them. The term 'Sole Trader' doesn't mean that you cannot employ staff, it simply means that you are responsible for the business, not that you have to work alone.

### **Agency**

Some agency workers are engaged by an employment agency to perform fixed term assignments at various businesses. Other agency workers are permanent employees of the employment agency, directly employed by the agency and sent to work for different businesses. This category is really about employment rather than being a contractor and running a business.

## **LIMITED VERSUS UMBRELLA**

### **Advantages & Disadvantages**

In this section we will briefly compare the advantages and disadvantages of running your business through either an umbrella company or a limited company. Later we will be reviewing take home pay calculations under each scheme using different scenarios. The table below is intended to give a brief summary of the advantages and disadvantages of Umbrella versus Limited.

<b>Limited Company</b>	<b>Umbrella Company</b>
<b>Advantages</b>	<b>Advantages</b>
Tax efficient and can claim more expenses.	Suitable for short term assignments 3 months or less.
Take advantage of the flat rate VAT scheme, the 5% allowance and the employment allowance.	Removes all administrative burden of running a business.
Retain risk and control.	Salary received net of Tax and NI so no further deductions.
Many clients prefer to deal with limited companies.	Suitable for Contractors starting out and trying out contracting for the first time..
<b>Disadvantages</b>	<b>Disadvantages</b>
Company is in the public domain and therefore your affairs are less private.	Expensive. Umbrella fees are high and you can claim less expenses.
Administrative burden of record keeping.	Many clients prefer to deal with limited companies.
Accountancy fees.	Lack of control as the umbrella company controls the finances.
<b>Note</b>	<b>Note</b>
A limited Company is always financially beneficial for long term contractors whether working within or outside IR35.	A contractor would only consider an umbrella company if working within IR35.

### Take-home pay calculations

Here we compare take-home pay for a contractor working under a limited company versus a contractor working under an umbrella company. The example illustrates examples of working both within and outside IR35. These calculations are based on current legislation and take into account the new dividend rules which considerably reduce the take-home pay for 2016/2017 compared to 2015/2016. It is a reasonably accurate comparison but individual expenses and circumstances will vary.



We can estimate that on average a contractor working through a limited company and outside IR35 on average will take home between 70% and 90% of the day rate. Obviously, the higher your day rate and earnings the higher the tax rate. The take home % will always be higher if the contractor has a partner/spouse that is a shareholder/director of the company. In the examples below we have used that scenario as it is commonplace with many contractors to maximise profitability.

Working through a limited company but within IR35 the take home pay is much less, in the region of 64% to 72%. As you can see from the calculations below it drops even further when working through an umbrella company. For the two examples the take-home pay percentage for an umbrella company is between 60% and 68%.

Note that many accountancy websites are still showing take home calculations based on earlier tax years. Significant dividend rule changes have taken place for 2016/2017 and the quoted take-home pay on some websites is being overstated.

<b>Limited versus Umbrella comparison £100K fee base</b>			
<b>Turnover, Allowances &amp; Expenses</b>	<b>Outside IR35 Limited Co</b>	<b>Inside IR35 Limited Co</b>	<b>Inside IR35 Umbrella</b>
Contractor Turnover	100,000	100,000	100,000
Flat rate VAT scheme	2,600	2,600	0
The 5% deduction	-5,130	-5,130	0
Direct business expenses	-12,000	-12,000	-10,000
Umbrella Co Fees	0	0	-1,500
<b>Total</b>	<b>85,470</b>	<b>85,470</b>	<b>88,500</b>

<b>Taxes &amp; NI Paid</b>			
PAYE	6,400	19,636	20,701
Employers NI	5,226	9,381	9,748
Employee NI	4,545	4,854	4,907
Employment Allowance	-3,000	0	0
Corporation Tax	5,849	0	0
Tax on dividend	2,679	0	0
<b>Total</b>	<b>21,699</b>	<b>33,870</b>	<b>35,356</b>
Take-home pay	67,271	55,100	53,144
<b>Take-home pay %</b>	<b>79%</b>	<b>64%</b>	<b>60%</b>

## Notes

- In the outside IR35 example there are two shareholders/directors.
- Salaries for the 2 directors are £43,000 and £11,000.
- Dividends are paid equally to both directors.
- Both directors qualify for £5,000 tax free dividends.
- For the limited companies to arrive at take-home pay you must add back the profit on the 5% allowance. In this example we have assumed £3,500.
- To qualify for the employment allowance there must be >1 on the payroll.
- Direct business expenses are in addition to the 5% allowance and are allowable expenses such as travel and subsistence.
- Take home pay = £85,470-£21,699+£3,500=£67,271

<b>Limited versus Umbrella comparison £50k fee base</b>			
<b>Turnover, Allowances &amp; Expenses</b>	<b>Outside IR35 Limited Co</b>	<b>Inside IR35 Limited Co</b>	<b>Inside IR35 Umbrella</b>
Contractor Turnover	50,000	50,000	50,000
Flat rate VAT scheme	1,300	1,300	0
The 5% deduction	-2,565	-2,565	0
Direct business expenses	-6,000	-6,000	-5,000
Umbrella Co Fees	0	0	-1,500
<b>Total</b>	<b>42,735</b>	<b>42,735</b>	<b>43,500</b>

<b>Taxes &amp; NI Paid</b>			
PAYE	0	5,507	5,605
Employers NI	810	4,199	4,473
Employee NI	705	3,657	3,716
Employment Allowance	-810	0	0
Corporation Tax	4,147	0	0
Tax on dividend	752	0	0
<b>Total</b>	<b>5,604</b>	<b>13,363</b>	<b>13,794</b>
Take-home pay	38,631	30,872	29,706
<b>Take-home pay %</b>	<b>90%</b>	<b>72%</b>	<b>68%</b>

## Notes

- In the outside IR35 example there are two shareholders/directors.
- Both directors receive a salary of £11,000.
- Dividends are paid equally to both directors.
- Both directors qualify for £5,000 tax free dividends
- For the limited companies to arrive at take-home pay you must add back the profit on the 5% allowance. In this example we have assumed £1,500.
- To qualify for the employment allowance there must be >1 on the payroll.
- Direct business expenses are in addition to the 5% allowance and are allowable expenses such as travel and subsistence.
- Take-home pay = £42,735-£5,604+£1,500 = £38,631

## TAXATION

### Vat and the Flat Rate Scheme

You are eligible to join the Flat Rate Scheme if you are a VAT-registered business and you expect your VAT taxable turnover to be £150,000 or less (excluding VAT) in the next 12 months. You must leave the scheme if on the anniversary of joining, your turnover in the last 12 months was more than £230,000 (including VAT) or you expect it to be in the next 12 months or you expect your total income in the next 30 days alone to be more than £230,000 (including VAT)

The benefits for contractors are that you bill your clients at the standard rate of 20% but only pay over to HMRC at the reduced rate. Each trade has different rates. As an example for IT contractors the rate in the first year is 13.5% and subsequent years 14.5%. The savings are illustrated below for 13.5% rate in the first year:

Turnover	VAT charged to Client	VAT paid to HMRC	Difference = Profit
50,000	10,000	8,100	1,900
100,000	20,000	16,200	3,800
150,000	30,000	24,300	5,700

### Corporation Tax

Corporation tax is the tax due on the Company's profits. See the table of rates below. You must pay your Corporation Tax 9 months and 1 day after the end of your accounting period. If the deadline falls on a weekend or bank holiday, make sure the payment reaches HMRC on the last working day before it. Tax payments should be paid on time as there are penalties and interest to be paid on late payment.

Your profits	From 1 April 2015	From 1 April 2014	From 1 April 2013
<£300,000	20%	20%	20%
Above £300,000	20%	21%	23%

### National Insurance

You will need to pay both employers and employees national insurance. However, employers can reduce the amount of National Insurance contributions they pay for their employees by up to £3,000. This is called the 'Employment Allowance'. You will not have to pay any employer National Insurance contributions at all if you usually pay less than £3,000 a year. Your accountant can advise on eligibility and conditions. The rates for 2016/2017 are detailed below:

Category A	£112 to £155 a week (£486 to £672 a month)	£155.01 to £827 a week (£672.01 to £3,583 a month)	Over £827 a week (£3,583 a month)
Employee	0%	12%	2%
Employer	0%	13.8%	13.8%

### Income Tax rates and bands

The table below shows the tax rates you pay in each band if you have a standard Personal Allowance of £11,000. The income limit for personal allowance is £100,000. For every £2 over the limit the personal allowance reduces by £1. Therefore, you do not get a Personal Allowance on taxable income over £122,000.

Rates Tax Yr 2016/2017	Taxable Income	Tax Rate
Personal Allowance	£11,000	0%
Basic Rate	£11,001 to £43,000	20%
Higher Rate	£43,001 to £150,000	40%
Additional Rate	Over £150,000	45%

### Tax on dividends Tax Yr 2016/2017

From 6 April 2016, you will not pay tax on the first £5,000 of dividends that you get in the tax year. Above this allowance the tax you pay depends on which Income Tax band you're in. Add your income from dividends to your other

taxable income when working this out. You may pay tax at more than one rate.

<b>Tax Rate on Dividends over £5,000</b>	<b>Tax Rate</b>
Basic Rate	7.5%
Higher Rate	32.5%
Additional Rate	38.1%

## **EXPENSES FOR LIMITED COMPANIES**

### **Allowable Expenses**

The basic HMRC rule is wholly and exclusively for the business and if so they can be claimed. If the 5% allowance is being claimed then the administrative costs of setting up and running the company cannot be claimed. These running costs would include accountancy fees. However, it is important to establish that if the actual running costs are greater than the 5% allowance then these additional running costs would also need to be claimed.

Allowable expenses would include:

- Office, property and equipment
- Travel expenses
- Clothing expenses where applicable
- Staff expenses
- Legal and Accountancy fees
- Marketing, entertainment and subscriptions

Due to various complications such as the flat rate VAT scheme, dividend payments, PAYE, NI etc... it is always worth speaking to us at Tax Compute to fully understand the impact on take home pay. We will be able to give you a more detailed explanation on how claiming expenses affects your take home pay.

## **Pensions**

Pensions are seen as an excellent tax-efficient form of investment. The contributions that you pay into your pension will benefit from tax relief, and reduced NI contributions. You will receive tax relief on the contributions that you make at the highest rate of income tax that you pay, provided that the total gross pension contributions do not exceed the lower of: your annual earnings and the annual allowance.

In Income Tax terms if you are paying tax at the higher rate of 40% for each £100 invested you pay £60 and HMRC pay the rest. At Tax Compute we recommend that you speak to a financial advisor before deciding on type of pension scheme and monthly contributions.

## **Travel**

When working outside IR35 all travel expenses to and from workplace can be claimed and these expenses are not covered by the 5% allowance. When working within IR35 there is a distinction between travelling to your normal workplace and travelling to a temporary workplace. Normal workplace travel is not allowable but travel expenses to a temporary workplace are allowable.

HMRC states that a place is a temporary workplace if an employee goes there only to perform a task of limited duration or for a temporary purpose even where the employee attends it regularly. HMRC also introduced the 24-month rule in 1998 which prevents a workplace being a temporary workplace where an employee attends it in the course of a period of continuous work which lasts, or is likely to last, more than 24 months. HMRC have produced full guidance on this subject which is available at the HMRC website.

## **The 5% Allowance**

The deemed employment payment calculation allows a flat rate 5% reduction from the total IR35 income received by your limited company or partnership. This allows for the general expense of running a business, such as training costs and the cost of looking for contracts. There is no restriction on the use of this allowance. You're not required to demonstrate this expenditure - the 5% deduction will be allowed in all cases.

## **COMPANY ACCOUNTS**

The accounts that your limited company will need to file are the Income Statement (P&L) and the Balance Sheet (BS). Limited Companies for contractors will not have the same reporting obligations as larger entities. These two financial reports are sufficient for annual filing.

The P&L is a financial statement that summarizes the revenues, costs and expenses incurred for the financial year to arrive at the net profit or loss. It is important to note that under the accrual method of accounting, revenues and expenses are recorded before cash actually changes hands. Therefore, what you see as profit may not actually equal what is in your bank account.

The BS presents a company's financial position at the end of its financial year and is a 'snapshot' of the company's financial position. The BS therefore summarises the company's financial position in terms of what it is owed and what it owes.

## **WHY CHOOSE TAX COMPUTE ACCOUNTING**

Tax Compute Accounting is one of the fastest growing practises in the UK. We are a family run business founded in 2014 and we already service a diverse portfolio of Contractors. We are qualified accountants and as such are regulated by two recognised accounting bodies CIMA and ICPA. That means we are duty bound to hold professional indemnity insurance to insure against any losses incurred through bad practice and advice. There are many accountancy firms that bypass this expense.

We possess the skills and experience to be able to provide a premium service to all our contractors. We will ensure that we provide the tax planning needed to maximise take-home pay. We will always provide our contractors with the most effective accounting and business solutions. Our prices are just £80/month for a fully comprehensive service. We do not charge over and above a flat rate of £80/month plus VAT which means if you have specific tax



questions relating to your company it will be researched free of charge. We will also normally answer all queries the same day.

We hope you choose us and look forward to a long and prosperous partnership. If you choose another practise we wish you good luck in your future career.

## PRICES

<b>Limited Companies £80/month plus VAT</b>
Free Initial Consultation
Dedicated Accountant
Ongoing Support, telephone and regular meetings & updates
Company Formation (Company set-up and filing with Companies House)
Company Accounts & Corporation Tax (Preparation & annual filing )
Self-Assessment
Tax Planning
VAT returns
Payroll
Spreadsheet (monthly bookkeeping)
Company Secretarial (All HMRC and Co. House filings and administration)
Registered Office
IR35 Review
Professional Indemnity (£300,000 cover)

## MAKING THE RIGHT CHOICE

When making your choice make sure that you make an informed decision taking into consideration all your personal and business concerns. If you choose an umbrella company you should undertake some research and if possible liaise with fellow professionals for advice and referral. You should also remember that you forgo financial benefits by not going limited. If you need more information or are not sure please contact the team at Tax Compute and we'll be happy to offer free advice. There are also several websites such as <http://www.contractoruk.com/> which give news and information on all aspects of contracting.

We have put together a checklist on cautionary points you should consider if choosing an umbrella company. They are briefly stated below:

- Beware of umbrella companies that claim they can deliver a higher take-home pay than that of their competitors. HMRC make the rules and if umbrella companies comply with those rules they should all achieve exactly the same result.
- Beware of promises that sound suspect. Particularly in respect of the umbrella company claiming that they can claim greater expenses over their competitors. Or they have special dispensations etc.... Remember HMRC make the same rules for everyone.
- Avoid using tax avoidance schemes such as Employee Benefit Trusts and various offshore schemes. These umbrella companies charge much higher fees and are under constant scrutiny by HMRC. In the future you could find yourself in a lawsuit with HMRC and you could end up repaying thousands in back taxes.
- Use established umbrella companies. Avoid using newer and smaller companies as there is increased risk. Remember they are in control of your money and if they ever go into administration your money will be lost.
- Make sure that the fees are fixed regardless of your fee base. Avoid using umbrella companies that charge a fixed percentage of your day rate. It will usually work out much more expensive.
- Umbrella companies are less financially beneficial for long term contractors.

If you choose to use a limited company we at Tax Compute Accounting can offer premium services at an extremely competitive rate. We are one of the fastest growing practices in the UK and are successfully building and enhancing our reputation all the time both locally and nationally. We operate on a fixed rate of £80/month. We consider our fees to represent exceptional value for money.

For some contractors it may be beneficial to simply operate as a Sole Trader. There could be a number of different reasons for this and we at Tax Compute Accounting will give you all the information you need to come to the right

decision. Our fees for sole traders start at as little as £30/month. Worth mentioning two cautionary points regarding operating as a sole trader.

- You have more credibility with clients if you operate through a limited company. Clients may prefer to work with limited companies to avoid potential IR35 issues.
- Sole trader status is usually only beneficial for contractors who have a lower income and fewer expenses perhaps because they work limited days or hours.