# Running a Limited Company

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## A practical guide for freelancers & contractors


Freelancers & Contractors
UK 200 group

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# Introduction

## A practical guide to running a limited company

Whether it's to earn more money or to do more of the work they love, more people are taking control of their careers and starting up as contractors and freelancers.

Find out how you can do the same with our guide to managing your own limited company.

## Benefitting Freelancers and Contractors

We consider the UK's small and medium-sized enterprises (SME) sector to be the lifeblood of the economy, which is why we specialise in providing a comprehensive range of accountancy and business services to this thriving portion of the UK workforce.

Between them, our members serve around 1,600 personal service/limited company clients and counting. This means we are well equipped to offer a broad range of services to new or current contractors or freelancers covering any aspect of limited company contracting, including:

> Company formation
> Legislative threats including IR35
> Taxation
> Financial planning

Through promoting quality standards and providing regular training on technical subjects, we ensure that our members have the tools to offer an exceptional level of service to their freelancer and contractor clients, in turn helping to nurture the burgeoning sector.

*The Freelancers and Contractors are a group of experts, all from UK200Group firms, who specialise in advising the freelance and contractor sector.*

*Using our shared knowledge and expertise and for the benefit of our clients we have together brought you this practical guide to running a limited company.*

**James Abbott**
Chair of UK200Freelancers & Contractors Industry Group

## About the UK200Group

The UK200Group is the UK's leading association of independent chartered accountants and law firms. Our association consists of more than 500 partners spread across approximately 150 member offices in the UK, while our international links span nearly 70 countries.

Our extensive group comprises a wealth of expertise and creates a platform for the exchange of knowledge and information, and consolidation of ideas across a range of specialist areas.

As a result, our members are better placed to support their clients, who benefit from an expert level of service in specialist and technical areas that would otherwise only be accessible via large national firms.

**Please note:** This guide is based upon tax rates applying to the 2018/19 year and is general guidance only. It is so important you receive appropriate advice tailored to your own individual circumstances.

# Freelancing and Contracting
## it's not a job, it's a lifestyle choice

If you are reading this, the likelihood is that you are considering joining the fastest growing segment of small businesses in the UK. According to the Association of Independent Professionals and the Self Employed (IPSE), there were roughly 2m Freelancers and Contractors in the UK in 2016, contributing £119bn to the UK economy.

For many it's an extremely attractive proposition, and there are plenty of reasons why more people are deciding to make the switch and work on their own terms.

> **More control over your career:** You are your own boss, meaning you decide the work you take on and the work you don't. You also have the final say over career development, meaning the freedom to learn and apply new skills according to your own preference and schedule.

> **Better work/life balance:** More control inevitably leads to an improved work/life balance. As a contractor you often don't have set working hours, you're never obliged to work overtime, and you can take more time off for holidays should you choose.

> **Increased earnings:** Contractors tend to have sought-after skills that clients will pay good money to access on an ad-hoc basis, meaning contractors often command higher fees.

> **Financial freedom:** Limited company contracting also opens the door to legitimate tax planning strategies to help you save money, as well as pension and investment opportunities.

These are the key drivers, though the advantages of limited company contracting aren't limited to these factors. If you're fully committed to the contractor lifestyle you'll find it richly rewarding.

# Inside the mind of a freelancer or contractor

You're most likely becoming a contractor after being a permanent employee. The first thing to get clear is that the two are nothing alike. There are many differences ranging from the basic characteristics of your contract to the tax treatment of your earnings.

The second is that a change of employment status requires a change of mind set. Below are a few aspects of contracting where a new approach is required.

## Your engagement with clients

As a contractor, you don't have employers, you have clients. Each job is a separate business undertaking where you have been hired to achieve a goal, rather than fulfil a role.

## Running your business

Aside from the work itself, you also have the day to day business of running a company. Running a company has many responsibilities that employees do not carry, although eventually this will become second nature.

## Winning contracts

Being in business, you need to market yourself and operate as such. Winning a contract is not the same as being interviewed for a job, and requires a different approach. Think of your skill as the product and yourself as the salesperson.

## Managing your finances

You also make your own personal provision for time off and retirement. This might mean buying insurances, saving money each month to cover holidays and sickness, or managing your own private pension pot. But in exchange for this, you still keep more of the money you earn and enjoy all the benefits that being your own boss entails.

# What are my trading options?

To make a success out of contracting or freelancing in the UK, you have two established trading options to choose from; running your own limited company or working via an umbrella company.

There are other choices, such as becoming a sole trader or joining with a colleague to form a partnership. But time and experience have shown the limited company and umbrella company options work best for contractors.

## Working under an umbrella company

The main responsibility of an umbrella company is to arrange and process payment for your work. It's essentially a service to process transactions, and removes much administration associated with running a company whilst taking care of matters such as tax and accountancy.

The major drawback is that you are employed by the umbrella company. So all of your income is subject to income tax via Pay As You Earn (PAYE), meaning it is taxed as employment income. You may be able to offset certain expenses against your tax liabilities, though you won't have the same tax efficiencies available to you as a limited company owner.

## Running your own limited company

Running your own limited company puts you in complete control over company matters, and allows for greater flexibility over how and when you receive payment. This increased flexibility opens the door to tax planning opportunities that can make for a far more lucrative contracting career.

There are some start-up costs, and you will incur outgoings for professional services such as accountants and insurance providers. There is also inevitable administration involved, though much of this can now be minimised by modern streamlined accountancy processes.

Ultimately, limited company contracting is more involved, but it allows for greater freedom, more control and often higher earnings.

# How to start your limited company

Once you have made the decision to incorporate your own company, there's a short checklist of tasks to complete before you're ready to begin trading. These can typically be carried out in a matter of days.

**Choose an accountant:** This isn't compulsory, but you'll struggle to stay on top of your tax and company administration if you don't. We have a wealth of contracting industry expertise to help you navigate complex tax laws and retain more of your income.

**Incorporate your company:** You can form the company yourself quite cheaply but most new freelancers need advice on who the shareholders and directors should be, so ask your accountant to handle the formation of the company and deal with the tax registrations on your behalf.
To incorporate you'll need to have established:

> A company name and address
> A director (yourself)
> Details of company shares
> Your company's SIC code

In addition, you'll need to provide details of people with significant control over your company. You'll also have to create a memorandum and articles of association, in other words, the company's written rules. Templates for which can be found on Gov.uk, or be provided by your accountant.

**Register with HMRC:** Registration with HMRC is required for you to set up a payroll, pay your company taxes and register for VAT, and is explained in detail on page 7.

**Set up a business bank account:** Your limited company is a separate legal entity to you personally, and so it needs its own bank account. This is explained in detail on page 15.

# Registering your company with HMRC

As soon as you have incorporated, you'll be able to register your company with HMRC. This is a quick and simple process, and a necessary one as it's the only way for you to pay company taxes. It's best to get this out of the way early, as failure to register your company with HMRC will incur a fine. Plus it can take a while for HMRC to complete some processes, such as VAT registration.


## Why you need to register with HMRC

Registration with HMRC is essential for your company to pay:

> Corporation Tax
> VAT
> Pay As You Earn (PAYE)

A number of forms need to be filed during the company tax year, including Corporation Tax returns, VAT returns, P11Ds and end of year submissions. Much of this is now completed online.

## How to register with HMRC

Shortly after you have incorporated, HMRC will send you a letter containing your company's Unique Taxpayer Reference (UTR) and form CT41G, providing information on Corporation Tax for new companies. You must register with HMRC for Corporation Tax within three months of starting up your business, and your UTR is required for you to register.

You can choose to register with HMRC yourself, but HMRC does allow tax agents and advisers – which usually means your accountant - to use its services on behalf of their clients. To help minimise your administrative load, and guarantee that deadlines for payments and submissions are met, we recommend that you let us take care of this for you.

# What you need to budget for

Contractors generally find that they earn more than their employee counterparts, but treat all your extra cash with caution when you first get paid, this money is not yours, but your company's.

You first need to remember that your limited company revenue is pre-tax, and so you need to hold a portion back for when Corporation Tax, Income Tax, VAT and potentially National Insurance Contributions (NICs) become payable. It isn't always easy to gauge exactly how much you should retain, but if you speak to us we can help you reach an accurate estimate.

From here on, we recommend that you make deductions from your earnings to account for costs incurred throughout the year, including:

> **Holiday and sick pay:** Running a limited company means making your own provision for time taken off for holidays and sickness. This could vary significantly based on how much holiday you plan on taking, and your state of health.

> **Pension:** Likewise, you have no employer paying into a workplace pension, so contributions into your own pension scheme is advised. Plus there are usually major tax savings when you make pension contributions.

> **Professional fees:** Part of your budget should be allocated for professional fees. This includes accountancy and consultancy fees, as well as contract reviews and professional advice from solicitors. These may seem costly at the time, but this expert input helps ensure that over the long term, and if something goes wrong, you keep hold of more of your money.

> **Business and protection insurance:** You and your company will need a range of insurance policies to help to protect both contractors and their earnings in the event of a dispute or mishap. There are numerous policies, which we cover on page 12.

> **Travel and subsistence:** Most contracts, especially those on a client's site, require a lot of travelling. A lot of these costs can be claimed back as expenses.

There are several variables impacting the fees that contractors set aside for themselves. This needs to be measured, which is why we offer financial planning for contractors as part of our service.

# **IR35** – understanding the intermediaries legislation

**IR35** – Otherwise known as the intermediaries legislation - is a tax legislation combating 'deemed employment'. Anybody who works through an intermediary, such as a limited company, needs to consider IR35 each time they seek a new contract. If HMRC finds that an individual would effectively be an employee of their client if the intermediary, or limited company, were removed from the equation, that individual would fall within the scope of IR35. Being caught by IR35 subjects you to employment taxes and can reduce your net income by 20% or more.

## How IR35 affects you

Genuine contractors forego the job security and employment rights that accompany permanent employment to enjoy the flexibility that contracting offers, which includes tax advantages.

The individual's HMRC targets attempt to gain the tax advantages of contracting without taking on the risk. Consequently, as a limited company contractor, you have to take measures to prove that you are genuinely in business on your own account.

## How is IR35 status determined?

IR35 is all about establishing employment status, which involves considering employment legislation and case law. This is highly complex, although your accountant, or a legal professional expert in IR35, can help assess your status. Essentially, there are three key 'tests of employment' to be aware of:

> **Control** – Does the client have control over how the worker carries out the work?
> **Personal service** – Is the worker required to provide services to the client personally?
> **Mutuality of obligation** – Is the client obliged to offer work and is the worker obliged to accept it?

## How you can stay compliant with IR35

Working in the private sector, you need to assess your IR35 status and tax yourself. If HMRC decides IR35 applies and you have not been paying the appropriate amount of tax, you will receive a bill for backdated taxes, penalties and fines. In famous IR35 cases, this sum has been well into six figures.

You're advised to acquire a professional contract review for each contract you undertake. This is one of the services that we offer to our contractor clients, as is explained on page 11.

If you are caught by IR35, income tax and National Insurance Contributions (NICs) need to be deducted from your income. The most straightforward way of doing this is to apply PAYE to your earnings.

# Public sector client?
## What you need to know about IR35

HMRC's tax yield from IR35 has consistently fallen short of its targets. So, from April 2017, enforcement of the legislation in the public sector has changed, with new responsibilities placed on public sector organisations engaging contractors.

### What this means for you

You may now encounter challenges contracting for a public sector client that you wouldn't face in the private sector. These could include:

> Receiving your fee via your client or agency's payroll
> Paying tax at source via Pay As You Earn (PAYE)
> Being asked to work inside of IR35, regardless of whether the legislation applies

### The key changes affecting you

> Hirers are responsible for assessing the contractors they engage for IR35. So, unlike IR35 in the private sector, contractors are no longer responsible for determining their own status.

> If the contractor is caught by IR35, the party closest in the supply chain to the contractor (the agency if present, otherwise the client) has to operate PAYE on their income, meaning income tax and NICs will be deducted at source.

> If HMRC successfully challenges a contractor's deemed IR35 status, the party closest to the contractor will be liable for backdated tax, penalties and interest – this risk may discourage many organisations from engaging contractors outside IR35.

> If it can be proven that the hirer didn't take 'reasonable care' when evaluating the contractor's status, the hirer may assume this liability.

### How to respond

Tax liability risk is a lingering threat for hirers and agencies, and your biggest challenge may be persuading them to hire you outside of IR35. This is why actively contributing to your status evaluation is encouraged.

As you would in the private sector, seek a professional contract review. Your expert can also help negotiate terms into your contract to minimise any risk to your agency or hirer.

# **IR35** – how we can help

IR35 poses arguably the biggest threat to the livelihoods of UK Freelancers and Contractors, and so tailoring our services to this sector has meant developing a comprehensive understanding of the legislation.

This, along with access to legal professionals within the UK200Group, means we are well equipped to help you avoid IR35, ensuring that you pay no more tax than you should.

## Our contract review service

Central to our IR35 offering is our contract review service. We have a wealth of experience identifying the risk factors of IR35, helping us to arrive at a sound judgement as to your employment status and how your income should be taxed.

In addition to minimising the risk of excessive taxation resulting from IR35, securing a contract review with our team demonstrates to HMRC that you are taking reasonable care in assessing your status, which will support your case if you happen to be subject to an IR35 investigation further down the line.

Our experts can also advise on how to adjust working practices to further mitigate the risk of IR35, and recommend necessary changes to your contract to help avoid IR35.

## Further compliance guidance

However, the contract is only one element of IR35, and our service offering is broad based in turn. We also provide specialist IR35 compliance advice to our contractor and freelancer clients. This includes guidance on:

> Compiling evidence for protection in the event of an HMRC IR35 investigation
> Negotiating IR35 compliance with agencies and clients
> IR35 mitigating protocols, such as securing written statements

# Your insurance options

Limited company contracting means you are running a small business, and being in business does bring certain risks. However, for a small portion of your monthly fees, you can protect yourself against these risks. Below are a few insurance policies that we recommend you consider.

## Business insurance

This covers a range of recommended insurances for limited company owners, including:

> **Public liability insurance:** to protect companies against claims made by third parties
> **Business equipment insurance:** to cover damage to or loss of business assets, such as computers and office equipment, your household insurance won't cover these assets
> **Employers' liability insurance:** a legal requirement if you employ anybody through your company

You can buy these insurances as a single package designed specifically for contracting businesses like yours.

## Professional indemnity (PI) insurance

If a client decides to take action over a perceived error in your work, they could pursue your company and possibly you as the company director for damages. Professional indemnity (PI) insurance covers defence fees and potentially a pay out if negligence can be proven.

## Insuring against IR35

To mitigate the risks of IR35, you can purchase tax investigation cover and possibly in certain circumstances tax liability cover. The former provides a defence, covering the costs of professional advisers should HMRC investigate, while the latter covers the costs of your tax settlement if HMRC successfully challenges your status.

## Income protection insurance

This will come in handy if you ever suffer a prolonged period of illness. This provides a level of cover based on an estimate of your annual contract earnings.

## Life insurance

Leaving employment means losing benefits including death in service that can support your family and/or dependants after you have passed. Purchasing life insurance provides a safety net for your loved ones in the event of such a tragedy.

# How to secure your first contract

One of the biggest challenges for a first-time contractor is securing their first professional contract. Agreeing a contract is very different to securing a full-time job, and so requires a distinctly different approach.

Contractors either contract for a client directly, or via an agency. The former tends to be an option for established contractors who have a large network within their industry, meaning the latter is the more common approach to sourcing work.

## Where to find a contract

There are three primary channels that you can use to source potential contracts advertised by clients and recruitment agencies:

> **Job boards** – As well as major job boards, there are many sites specifically targeting contractors and specialist industries
> **CV databases** – Uploading your CV to a database alerts recruitment agencies to your skills and availability
> **Social media** – Sites such as LinkedIn are increasingly essential for finding contracts, as well as marketing and networking

## How to market yourself

Your CV and LinkedIn are the two key components of your marketing collateral. You could find the ideal contract, but in order to get it, your CV and LinkedIn profile will have to demonstrate that you're perfect for the job.

When writing your CV:

- Tailor it to the role in question, with relevant skills and experience featuring more prominently
- Demonstrate the value that your skills have added for previous clients or employers
- Keep it concise and relevant

Recruitment agents will often search for you on LinkedIn as part of their vetting process. Some tips for marketing yourself via LinkedIn:

- Maintain an active profile and fill it with industry relevant content
- Optimise your profile for search engine optimisation (SEO) in order to be found by more recruiters
- Use the platform to network and join industry forums

Following the guidance above will help gain the attention of recruitment agencies, who for the vast majority of contractors source the first and many subsequent contracts.

# Working with agencies

Unless you're already well connected in your industry, your first contract will almost certainly be sourced via a recruitment agency. Agencies provide access to a wide network of potential clients, and are often key to securing further work. Some clients will only hire contractors this way, as the agency's presence eliminates many risks.

## How agencies win you work

The primary duties of a recruitment agency are relatively straightforward:

> Match contractors with suitable contract opportunities
> Negotiate contract rates and fees with the contractor and client
> Secure the contractor an interview
> Assist in negotiating any possible contract renewals

Agencies take a cut of your earnings, but they do plenty to justify their fees. However, don't forget recruiters are working for the client and not you, the candidate, and you are in business, not looking for employment. So make sure you negotiate a good deal.

## Negotiating your rate with agencies

Your agent acts as a broker between you and the client, and may wish to establish your contract rate before arranging an interview. You aren't obliged to confirm your rates, although it is good to get a ballpark figure so you and the recruiter are not wasting each other's time. However, if you choose to do so, there is a general rule of thumb to follow.

Research the going market rate for your skills before proposing a rate towards the top end of that bracket. Agents that are not on a fixed percentage – often the smaller agencies, but not always - will often try to bargain to secure a healthy margin for themselves, so aim high to begin with.

# Getting paid – your responsibilities

Unlike permanent employment, you can't expect a salary to appear in your bank account at the end of each month. Getting paid for work completed as a limited company contractor can at times be more challenging and can mean undertaking several tasks.

> **Completing timesheets:** These are provided by your agency, or your client if working direct, and are used to confirm the hours or days that you have worked during the week or month.

> **Issuing invoices:** Remember you are a business so you need to invoice your customer – the agency or client – for the services your business delivered. This is explained in detail on page 16.

> **Collecting payments:** Your invoice will typically require payment within 30 days, which is standard for business-to-business relationships. Many agencies pay much faster. However, not all clients and agencies pay within 30 days. Some have 60 or 90 days terms and others are simply poor payers you need to chase.

> **Managing late payers:** Late paying clients are an occupational hazard for contractors and other small businesses. If you do encounter persistent late or non-payers, there are several options, including using a credit collection agency or filing a claim with MoneyClaim Online.

## How to set up a business bank account

Your company is a separate trading entity to you, and so you will need a business bank account to receive payment. There are several business banking solutions online.

Many of these are tailored for one-person contractor limited companies and can process your application faster and without the unnecessarily rigorous vetting practices that many high street banks undertake.

These are typically cheap and relatively quick to set up and readily accessible online or via your mobile.

# How to prepare an invoice

Once you have a timesheet that has been signed by the client, you need to prepare an invoice. Unless you are contracting direct with a client, the likelihood is that you will invoice your agency for the work completed, who will in turn bill the client with its margin on top. Otherwise, you will invoice the client direct.

## What to include in your invoice

Your invoice needs to follow a very specific format. Failure to do so can sometimes result in the invoice going unpaid. In fact, you may find some clients use minor errors on an invoice as an excuse not to pay you at all – don't give them that excuse. The details that it needs to contain include:

- Your company name, address and contact details – include your company number and registered company address
- Invoice date and due date for payment
- The invoice number
- Hours/days being billed for and hourly/daily rate
- Expenses recharged to the client if applicable
- The total value that the above amounts to
- The amount of VAT charged and company VAT number
- Total invoice value
- Terms of payment

## What else do I need to know?

As you are in a business-to-business relationship, you will typically request that payment is made within 30 days. However, agencies tend to pay contractors within a week of billing the client themselves, so you may not have to wait that long for payment.

Most agencies and clients require that each invoice is accompanied by the relevant timesheets, but be sure to retain a copy of each timesheet before sending them over.

You might issue an invoice electronically or in paper format, depending on the agency or client's preference. Invoice templates are easily accessible online, and we're always on hand to help if you need any further guidance. In fact, many accountants now provide solutions with invoicing capabilities. Speak to us for more information.

# Claiming expenses through your company

One of the benefits of being a limited company owner is that expenses can be claimed back from your business and can reduce your tax bill. This may appear counter-productive, as every expense claimed reduces your company profit margin, but a reduced profit means a lower Corporation Tax bill at the end of the year, saving you money.

If these are legitimate business expenses that you would have incurred anyway, it makes perfect sense to claim them out of pre-taxed money through your limited company.

## How do you claim expenses?

Expenses incurred wholly and exclusively for the purposes of the business can be claimed in a number of different ways:

> **Direct payments from your company bank account:** This is the most common method of recording your expenses as they are paid for directly out of company funds and are easily identifiable by your accountant.

> **Company Credit Card:** This method again allows for easy identification and recording of company expenses. It is important to retain your credit card statements and all related purchase/expense invoices so that your accountant can identify what the expenditure is related to.

> **Petty cash:** Often directors will draw cash from the company bank account and use this cash to pay for company expenses. This is most commonly used for travel and subsistence costs, particularly when travelling abroad. This is a totally acceptable method of incurring business costs provided that receipts are retained in support of the expenditure.

> **Expenses borne personally by the director:** It is also possible for a director to incur expenses on the company's behalf. These can be reclaimed from the company at full value provided evidence exists that the expenditure was genuinely incurred, usually by way of a periodic expense claim.

Regardless of how it is incurred, each expense should be supported by an invoice or receipt and needs recording. Most accountancy services include an expenses recording and payment process, and many online providers now offer solutions whereby expenses records are automatically updated as soon as you upload an image of a receipt from your phone.

If you don't already have a recording and payment process in place, you needn't worry. You can easily record your expenses in an excel spreadsheet, and only basic information is required:

> The date of the expense
> What the expense was for
> The amount of the expense

If you record expenses manually, be sure to hold on to all original receipts, or photos/ scans, as your accountant may need to verify any unusual costs. Similarly, if you wish to claim VAT on an expense, you need to provide a VAT receipt.

Your own cash expenses can be claimed at any point throughout the year but it is good practice to claim regularly and keep tabs on VAT expenditure. Credit card use and company capital expenses can be claimed at any time, although you'll find that most contractors claim these expenses on a quarterly basis to align with their VAT returns.

# What you can claim as expenses

In this section we are assuming you are not caught by the additional tax liabilities arising from IR35 and working through your own limited company.

There are a number of costs that you can generally claim as allowable expenses, including:

> Financial costs, including accounting fees and insurance
> Certain advertising or marketing costs
> Business purchases, such as laptops and stationery
> Mobile phone (contract must be in the company's name)
> Travel, subsistence and accommodation for travelling to a temporary workplace
> Protective clothing for work

## Don't forget the golden rule

To qualify as a legitimate expense without causing tax problems, tax rules dictate, that the cost needs to have been incurred wholly, exclusively and necessarily in doing your job for your limited company. Practically speaking that means the additional cost of being a freelancer.

The tax rules regarding expenses can be complicated and it's important to take advice, however, the good news is that your UK200Group accountant can help you claim legitimate expenses without falling into the many traps that exist.

## Am I eligible for tax relief on travel and subsistence expenses?

One of the most common expenses for freelancers is travel and subsistence. You claim these from your limited company so long as your costs are incurred in travelling to a temporary workplace.

Broadly, a temporary workplace is a location where you are there for a limited duration and have not and expect not to be there for more than 24 months.

# **Financial flexibility** paying yourself via salary and dividends

Savvy tax planning can make a significant difference to your contracting income. Paying a combination of a low salary and dividend is generally the most tax-efficient way for limited company contractors to take remuneration from their business.

## How does the low salary/high dividend model work?

The low salary/high dividend model is effective because those who operate it pay less tax and National Insurance Contributions (NICs) overall than those who pay themselves higher salaries.

This is a legitimate tax planning strategy. Many contractors consider the tax advantages it brings to be fair exchange for the employment rights that they lose, and the additional costs of protection insurances, when they decide to take the limited company route.

## How does it help you save?

Each component of the low salary/high dividend model has its own advantage:

- The dividend is taxed at a lower marginal rate than employment income and doesn't attract NICs
- Taking a salary reduces the amount of income you are drawing out of company profits, thus reducing the overall Corporation Tax liability

As a limited company owner, you would typically pay yourself a salary that falls below the personal allowance (PA) and NICs thresholds.

Then you draw a dividend. You can use up any remaining PA to draw dividend income tax free.

In 2018/19 you also have a Dividend Allowance of £2,000 to use. This means the first £2,000 of dividend income which exceeds your PA is also drawn tax-free, although it reduces your basic rate tax band by the same amount (explained in more detail on page 24).

It's important to note that the dividend tax brackets apply to all earnings, so issuing a salary won't delay the point at which you enter higher tax brackets.

# The low salary/high dividend model
## how does it work?

Here we compare two limited company owners who have each made an annual profit of £70,000. One takes a salary, and the other takes the low salary/high dividend approach.

### Salary

| Aanya Sodhi | |
|---|---|
| Gross income | £70,000 |
| Salary | £62,533 |
| Gross pre-tax profit | N/A |
| Employers NI | £7,467 |
| Employees NI | £4,875 |
| PAYE | £13,373 |
| Corporation Tax | N/A |
| Net profit | N/A |
| Dividend income tax | N/A |
| **Post-tax income** | **£44,285** |

**Aanya Sodhi** chooses to pay herself via salary. Employer's NICs are first deducted on earnings above the £8,424 secondary threshold, leaving £62,533 to be distributed as salary.

Having accounted for the £11,850 personal allowance, Aanya pays £13,373 in income tax via Pay As You Earn (PAYE).

Aanya also incurs employee's NICs, amounting to £4,875.

With £13,373 paid out in income tax and £12,342 in NICs, Aanya receives £44,285 in post-tax income.

### Dividend/salary split

| **Joe Bloggs** | |
|---|---|
| Gross income | £70,000 |
| Salary | £8,000 |
| Gross pre-tax profit | £62,000 |
| Employers NI | N/A |
| Employees NI | N/A |
| PAYE | N/A |
| Corporation Tax | £11,780 |
| Net profit | N/A |
| Dividend income tax | £6,295 |
| **Post-tax income** | **£51,925** |

**Joe Bloggs** pays himself a salary of £8,000. This attracts neither income tax nor NICs.

The remaining £62,000 incurs Corporation Tax at a cost of £11,780. Joe still has £3,850 of his personal allowance and the £2,000 Dividend Allowance to use, meaning dividend tax applies to the remaining £44,370.

Joe pays a total of £6,295 in dividend tax (see page 24). When deducted from his gross income alongside Corporation Tax, Joe is left with a significantly higher post-tax income of £51,925.

# How to manage your payroll

Every employer has to run a payroll, so that their employees get paid, and so that payments and tax deductions can be reported to HMRC. As both the director and an employee of your limited company, you are obliged to do so as well, and must prepare payslips on a monthly basis.

This may sound burdensome, but a full payroll service is part of the package that many specialist accountants provide to limited company owners, and is certainly within scope of the services that we offer.

So in reality, nothing much is required of you from this perspective. Your job will simply be to provide your accountant with the information required to carry out the calculations, and potentially pay any income tax and National Insurance Contributions (NICs) as required.

## What is Real Time Information (RTI)?

HMRC introduced RTI to help understand the tax positions of individual taxpayers in real time, removing the need for large adjustments at the end of the tax year. It only applies to employment income (your salary), meaning reporting of dividends and filing of Corporation and Self-Assessment tax returns aren't affected.

Payroll data now needs to be reported to HMRC in real time, on or before the date that employment income is paid. As a result, you may find that your accountant sends you a payslip and an RTI return once a month, although in the majority of cases this will be dealt with automatically online.

Providing your annual salary is below the NICs threshold, no income tax or NICs will be due. Otherwise, any payment due to HMRC needs to be made online prior to the 22nd of the month following the RTI submission.

# Paying dividends – the paperwork

You can issue dividends at any point throughout the year, as long as you have sufficient profits in the company, although certain paperwork needs to be completed for the dividends to be valid.

You may find that with your accountancy provider you are able to pay a dividend and prepare the relevant paperwork automatically. This is all providing your income and expenses reporting is up-to-date.

Otherwise, you'll need to understand how to prepare board minutes and dividend vouchers, two simple pieces of paperwork that Companies House requests and are issued at each board meeting whenever a dividend is paid.

## What is a board minute?

As soon as your company – which in practice means you and any co-directors such as your spouse or civil partner - has agreed to distribute dividends, it needs to be acknowledged in the minutes of the board meeting.

This will typically be prepared by the company secretary, although your accountant can prepare board minutes for you. The minutes must be signed by a company director before becoming part of the company records.

This is a straightforward procedure, with the board minutes simply needing to acknowledge:

> The dividend amount per share
> The date of the meeting
> The date that the dividend is paid

## What is a dividend voucher?

This is the equivalent of a dividend receipt, and is issued to each shareholder in your company who receives a dividend. It contains the same basic details as the board minutes, only each shareholder keeps the dividend voucher to include within their Self-Assessment tax return.

## A warning about backdating dividends

Remember that this paperwork needs to be completed the day the dividends are issued and should not be backdated.

# Tax – what you need to remember

Depending on how you run your company and draw income, you or your company will be liable for some or all of the following taxes:

- **Corporation Tax:** This needs to be applied to limited company profits prior to the distribution of dividends.
- **Income tax:** If you pay income tax on a salary, it needs to be included in your Self-Assessment tax return. This is generally paid via two payments on account, the deadlines for which are 31st January and 31st July of each year.
- **National Insurance Contributions (NICs):** If your earnings are above the NIC threshold (currently £8,424), you and your company will be liable for employee's NICs and employer's NICs respectively.
- **Dividend tax:** This is a tax applied to dividends, and needs to be declared in your Self-Assessment tax return at the end of the year.
- **Value Added Tax (VAT):** You can charge VAT on your invoices and pay VAT on company expenses. You need to report this quarterly.

## Making Tax Digital (MTD)

With Making Tax Digital (MTD), HMRC is looking to phase in digital reporting of taxes, which could turn the traditional tax calendar on its head. The regime will require businesses to maintain records of income and expenditure via digital accounts and report to HMRC on a quarterly basis. This will be in addition to an annual statement.

Speak to us for more information on MTD, what it means for your company and how we can help you navigate the changes.

## Tax – the key dates for your diary

| | |
|---|---|
| 6th April: | New tax year begins |
| 31st July: | Due date for second payment on account |
| 31st October: | Deadline for paper Self-Assessment tax return |
| 31st January: | Deadline for online Self-Assessment tax return and first payment on account |

Your company will also have a financial year depending on when you begin trading. For example, your financial year might span from 1st July to 30th June the following year.

You also have an accounting period for Corporation Tax, which in most cases will match your financial year. Your accounting period is the time covered in your Company Tax Return Form CT600, which needs to be filed within 12 months of the end of the accounting period. On top of this, you usually submit a VAT return to HMRC every three months.

# How to calculate your dividend tax liability

Financial flexibility is one of the major benefits of limited company contracting. Taking your payment as dividends provides this flexibility. Paying yourself a dividend rather than a salary also means your income doesn't attract National Insurance Contributions (NICs).

Once you have calculated how much profit the business has made, you then need to calculate Corporation Tax at the prevailing rate so you know how much tax to set aside. After which point you are ready to calculate your dividend tax liability.

## Don't forget your allowances

An allowance is an amount of income that you can draw tax-free each year. Before applying dividend tax, you should consider your allowances. These are:

**Personal allowance (PA):** Providing your annual income doesn't exceed £100,000, you have a tax-free personal allowance of £11,850.

**Dividend Allowance:** The first £2,000 of every dividend payment is taken tax-free, though it eats into the basic rate band, shrinking it from £34,500 to £32,500. HMRC refers to this as an allowance, but in fact it's a zero-rate band, due to the fact that subsequent tax bands are affected.

Remember, you can apply your PA to the dividend you draw, meaning the equivalent amount will be taken tax-free.

## Applying dividend tax rates

After this point, dividend tax needs to be considered. Below are the dividend income tax rates for 2018/19, which are markedly lower than the equivalent tax band rates for employment income, helping this model to deliver greater take-home pay:

| Tax band | Tax rate | Income |
|---|---|---|
| Basic rate | 7.5% | £0 - £34,500 |
| Higher rate | 32.5% | £34,501 -£150,000 |
| Additional rate | 38.1% | £150,001 + |

Here's how a contractor who has taken an £8,000 salary and a £60,000 dividend would work out their dividend tax:

- £8,000 of the PA is used on the salary. The remaining £3,850 is deducted from the amount of dividend that is taxable, leaving £56,150.
- The Dividend Allowance is £2,000 and eats into the basic rate band, leaving £54,150 that is subject to dividend tax.
- The first £32,500 (£34,500 - £2,000) of this is taxed at the 7.5% basic rate, which works out at £2,437 in tax. The remaining £21,650 attracts £7,086 in tax at the 32.5% higher rate. The contractor pays £9,473 in tax in total.

This is a basic example of how dividend tax is applied. Depending on your personal circumstances, you may be able to draw income even more tax-efficiently. Speaking to us can help you identify the best tax strategy for you.

**Please note:** Scotland sets its own tax rates and bands which differ slightly to those applying to the rest of the UK. The example applies to a non-Scottish freelancer.

# Value Added Tax (VAT)

Value Added Tax (VAT) is the UK sales tax, levied at a standard rate of 20% on all goods and services except those that are exempt or zero rated. Businesses whose gross income is above the £85,000 VAT threshold (correct as of 2018/19) are obliged to register for VAT, which will include most contracting businesses.

You collect VAT for HMRC by adding it to the invoices that you give to your clients (output VAT). This is then paid on to HMRC, usually on a quarterly basis. However, you can also claim back VAT from your business expenses such as technology or equipment (input VAT). Your company will pay the difference between the amount of input VAT collected and output VAT claimed on a quarterly basis.

VAT can prove to be an effective way to save money, particularly when you are setting up to begin with. Here are the key advantages:

> The VAT amount paid on business expenses can be deducted from your company's VAT liability when your quarterly payment is due.
> Making quarterly payments in itself means your company benefits from a cash flow advantage
> You can also earn interest on the money

## The VAT Flat Rate Scheme (FRS)

The downside to VAT is having to prepare VAT returns, which means maintaining accurate records for each transaction included. HMRC introduced the VAT Flat Rate Scheme (FRS) for smaller companies who want to claim VAT with less administrative hassle.

The scheme allows users to pay VAT at a fixed rate. The rate is determined by the company's revenue and industry, and can vary from 4% to 16.5%. Under the FRS, you can only claim VAT back on specific large capital goods purchases.

After finding that some users were making a modest profit from the initiative, the Government introduced changes in April 2017. The 16.5% higher rate now applies to any company whose goods cost less than either:

> 2% of its turnover
> £1,000 a year (if its costs are more than 2%)

HMRC refers to companies in this mould as 'limited cost businesses'. Unfortunately, most contractor limited companies will fall within this remit, meaning you'll likely find that registering for standard VAT is now more beneficial for your company.

# PAYE & NICs

Running a limited company allows you to capitalise on tax planning strategies that can help you retain more of your earnings. If you are paying income tax and National Insurance Contributions (NICs) via Pay As You Earn (PAYE), you aren't making the most of your earning potential.

## PAYE

PAYE is used by HMRC to collect income tax and NICs from employment, whereby a deduction is calculated and made each time the employee is paid. This is taxing 'at source'. Making regular income tax and NICs payments complicates matters if you are a contractor or freelancer, as your annual tax liability is less clear-cut than that of someone on a fixed salary.

Given that limited company owners typically receive most of their remuneration through dividends, they don't tend to pay NICs above the minimum amount required.

## How to operate PAYE

However, if your contract is caught by IR35, your pay will be subject to employment taxes. In which case, making payments via PAYE is the easiest option. This requires your limited company to operate PAYE as part of its payroll, and is a service that we readily provide.

Payments and deductions need to be reported to HMRC on or before each pay day, whilst annual reports need to be made at the end of the tax year, including details of any expenses or benefits.

Overall there is nothing to gain from operating PAYE, and it means further admin if you decide to run your own payroll rather than outsource it. If you are working outside of IR35, you stand to make much more by taking the low salary/high dividend approach.

# Corporation Tax

You pay Corporation Tax on your limited company profits. Your profits are calculated after expenses and employee salaries have been deducted from fee income, but prior to the distribution of dividends. The UK's Corporation Tax rate currently stands at 19%, and the Government intends to reduce this to 17% by 2020.

## How is Corporation Tax determined?

Corporation Tax is applied to your net company profit. In addition to your company trading profits, you will also need to consider profits from:

- Investments, including returns from rental property that your company owns, etc.
- Chargeable capital gains, including profits from the sale of business assets, etc.

Expenses need to be deducted from your company profits, as do any employee salaries. The figure remaining will be the sum from which Corporation Tax is deducted.

## How and when do I pay?

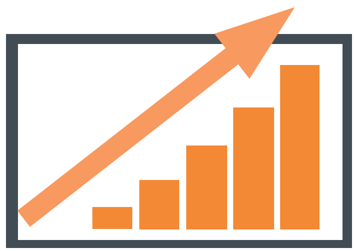
You need to submit your Corporation Tax return - an online form called a CT600 - to HMRC annually. This informs HMRC of your Corporation Tax liability by detailing your limited company's income, tax allowances and expenses, though in practice your accountant takes care of this for you.

You have until nine months after your company's financial year end to pay your Corporation Tax liability, though peculiarly you can file your return up to 12 months after the company year end.

## Setting aside money for Corporation Tax

If you are used to having tax deducted at source, paying taxes annually can come as a bit of a surprise. Throughout the year you need to set money aside for Corporation Tax, potentially income tax on your salary, NICs and dividend tax on your dividends.

By running a basic profit and loss account report each month, we can provide you with an accurate estimate of how much you need to hold back as a portion of your earnings.



# Your Self-Assessment tax return

As both the director and an employee of your own limited company, you'll need to keep on top of both company and personal taxation, which involves preparing a Self-Assessment tax return each year. In reality, we take care of all of this for you, though it helps to have an understanding of exactly what is required of you.

## What is a Self-Assessment tax return?

Your Self-Assessment tax return is used to determine the amount of income tax, dividend tax, NICs and capital gains tax (CGT) due, on income drawn from your company, as well as any other possible sources of income such as rental properties and other investments you own personally. It applies to any person who receives income from which tax isn't deducted automatically – for you this will likely be income sourced through dividends and other investments.

To complete your tax return, your accountant requires details of any personal income received throughout the tax year, as well as details of any expenses and information regarding other income sources. Depending on your accounting solution, you may provide this information throughout the year. Otherwise, you'll need to keep careful records.

## Don't miss the deadlines

If you file your Self-Assessment tax return by paper, the deadline is 31st October following the end of the tax year. For online tax returns, the deadline is the following 31st January, which is also the deadline for payment.

If your income tax liability exceeds certain limits HMRC will request a payment on account – an advance payment on your next tax return judged from your income from the prior tax year – on 31st January in the 5th April tax year and 31st July following the end of the tax year.

It's also important to remember that this is a personal tax return. As a result, if you charge the fees for completing the tax return to your limited company, it will be classed as a benefit in kind and income tax will be due on it.

# End of year accounts

When we refer to 'end of year accounts' we don't mean the end of the calendar year but rather the end of your company's financial year. This will initially depend on when your company is incorporated. However, the year end date can be changed if required but the company must file statutory financial statements with Companies House within 9 months of its year end.

## Company Tax Return Form CT600

Your company also needs to submit a Company Tax Return Form CT600. Your accountant completes this based on the financial records that you provide, and you need to check and sign the return before it's submitted.

This return will detail your Corporation Tax liability. Although you have 12 months from the end of your company's financial year to file a CT600, Corporation Tax is in fact due nine months after the company year end.

So, if you have a financial year that ends on 31st March 2018, a CT600 will be due on 31st March 2019, yet your Corporation Tax payment as stated on the return will be due on 1st January 2019.

## Submitting VAT returns

Most limited company contractors submit VAT returns every three months, a period which is known as your accounting period. Though this is separate from your financial period, many contractors have an accounting period that aligns with their financial period, meaning a VAT return is also due on the same date that a Form CT600 is due.

## Making Tax Digital (MTD) – the end of end of year accounts?

HMRC's plans to introduce a fully digital tax system could change all this. Making Tax Digital (MTD) will require companies to use digital accounts to keep records and report to the taxman on a quarterly basis, meaning end of year accounts could soon be a thing of the past. To find out about how MTD might impact your director duties, get in touch.

# Why you need financial advice

Whilst running your own limited company does mean that you have to make provision for yourself in many regards, the financial flexibility that it allows can yield some surprising tax advantages for your personal finances.

You'll also find that you have access to certain services that you may not have known were available. Securing sound financial advice from a specialist adviser who understands contracting is essential though. A good idea would be to make us your first port of call.

## Tax saving opportunities with contractor pension schemes

With no company pension scheme available, many contractors set aside a portion of their earnings each month to go into a private pension fund, which actually offers significant tax saving opportunities.

Unlike earnings drawn from the company, money paid into a pension pot by the company is pre-tax, so doesn't attract Corporation Tax, income tax or NICs.

Most limited company contractors can currently invest up to £40,000 each year, and can choose to buy an annuity or invest in other assets upon retirement, should they wish.

You can draw on your pension from the age of 55. This might seem like a long way off, but it can be worth it.  If you wish to discuss pensions or financial planning in general, please let us know.

## Mortgage options available to contractors

For limited company contractors, securing a mortgage was once a difficult task, with banks and building societies typically requesting up to five years of accounts.

However, there is now an increasing amount of mortgage lenders willing to provide loans based on an estimate of a contractor's gross contract value, and many brokers who specialise in advising contractors. In many cases, all the lender will need to see is the accountants reference detailing historical performance.

## Other savings and investments

There are many other opportunities open to contractors, who can also use their limited companies as vehicles for investment. This can encompass anything from equities and artworks to precious metals and property portfolios. There are special rules that apply if you use your company for investments so for further information and guidance on the potential options available to you, get in touch.

# Thinking about growing your business?

You may eventually find that you have ambitions beyond contracting. It could be that you no longer wish for your company revenue to be reliant on you alone, or you feel that you could profit even further from the expertise you have amassed during your career and the contact networks of clients and other contractors. Either way, your limited company provides you with the platform to build a growing business.

## Options for growing your business

Many contractors eventually decide to move into consultancy, meaning they continue to share their expertise and knowledge with clients without actually having to put their skills into practice delivering the work. This is ideal if you reach a stage where you have amassed a lot of knowledge and you're keen to reduce your workload without necessarily reducing your income.

Alternatively, it may be that you spot an opportunity to market a specific skill, process or product that resolves a common issue – new software is a good example of how contracting businesses have grown. In either case, hiring and managing contractors enables you to reach more clients and maximise on your revenue earning potential. It can also be an effective way to fill your own skills gaps. In other words, if there are any skills that you don't possess, hire somebody who does.

## Preparation is key

Whilst starting up as a limited company contractor is relatively straightforward, growing your business – which may include employing people and securing premises - is far more involved. You'll need to have developed a solid business plan and considered how you are going to market your services. Financial planning is also a necessity, and is another area where we can add considerable value, helping you to create and implement a strategy that will give your business the best chance of success.

# Glossary

**Companies House:** The Government service used to incorporate and dissolve companies, as well as register company information and make it available to the public.

**Company Tax Return Form (CT600):** A return completed on behalf of a company each year, detailing its Corporation Tax liability.

**Contractor:** An individual who provides their services to a client on a contract basis, typically as a business-to-business exchange.

**Contract review:** An evaluation of a contract, carried out by an accountant or legal expert, used to determine IR35 risk and assess commercial terms.

**Corporation Tax:** Tax paid on the profits of a company, following the deduction of expenses and employee salaries.

**Deemed employment:** An HMRC term used to describe an individual who has been paying tax as though they are a self-employed contractor but whose working practices mean they are legally an employee.

**Dividend tax:** Income tax applied to the distribution of dividends at significantly lower rates than personal income tax.

**Expenses:** Costs incurred that can be offset against an individual's or company's tax liability.

**Freelancer:** Somebody who works on a self-employed basis who isn't committed to a particular employer long-term.

**Income tax:** Tax paid on personal income.

**IR35:** Tax legislation with the purpose of identifying 'deemed employees' and ensuring that they receive the correct tax treatment.

**Limited company:** A private company which operates as a separate legal trading entity from its owners, insulating them from business risk.

**National Insurance Contributions (NICs):** A tax paid by employers and employees used to fund state benefits.

**Pay As You Earn (PAYE):** HMRC's system used to collect income tax and National Insurance Contributions (NICs) from employment.

**Payroll:** A company's records of its employee's salaries or wages, as well as deductions of income tax and National Insurance Contributions (NICs).

**Personal service company (PSC):** A term devised by HMRC used to describe a company that exists only to hire out the services of a sole individual.

**Personal allowance (PA):** An amount of income that an individual can earn within a tax year before income tax becomes due at the basic rate.

**P11D:** A tax form filed by employers to report expenses and benefits to HMRC for individual company directors or employees.

**P35:** An annual return completed by employers, providing details for everyone employed during the tax year.

# Glossary

**Reasonable care:** A compliance requirement for anybody responsible for assessing a contractor's IR35 status, believed to equate to acquiring expert advice.

**Real Time Information (RTI):** A system implemented to make PAYE submissions more efficient, instantly informing HMRC of changes when information is submitted.

**Recruitment agency:** An organisation that places candidates in suitable contracts, negotiating terms and overseeing the recruitment process.

**Self-Assessment:** The end of year tax return used to determine how much tax is due on an individual's personal income.

**SIC (Standard Industrial Classification) code:** A code assigned to a company which informs the Government of its nature of business.

**SME:** Small and medium-sized enterprises whose personnel numbers and annual turnover fall below certain limits.

**Tax-planning:** The analysis of a financial situation with the purpose of achieving greater tax-efficiency.

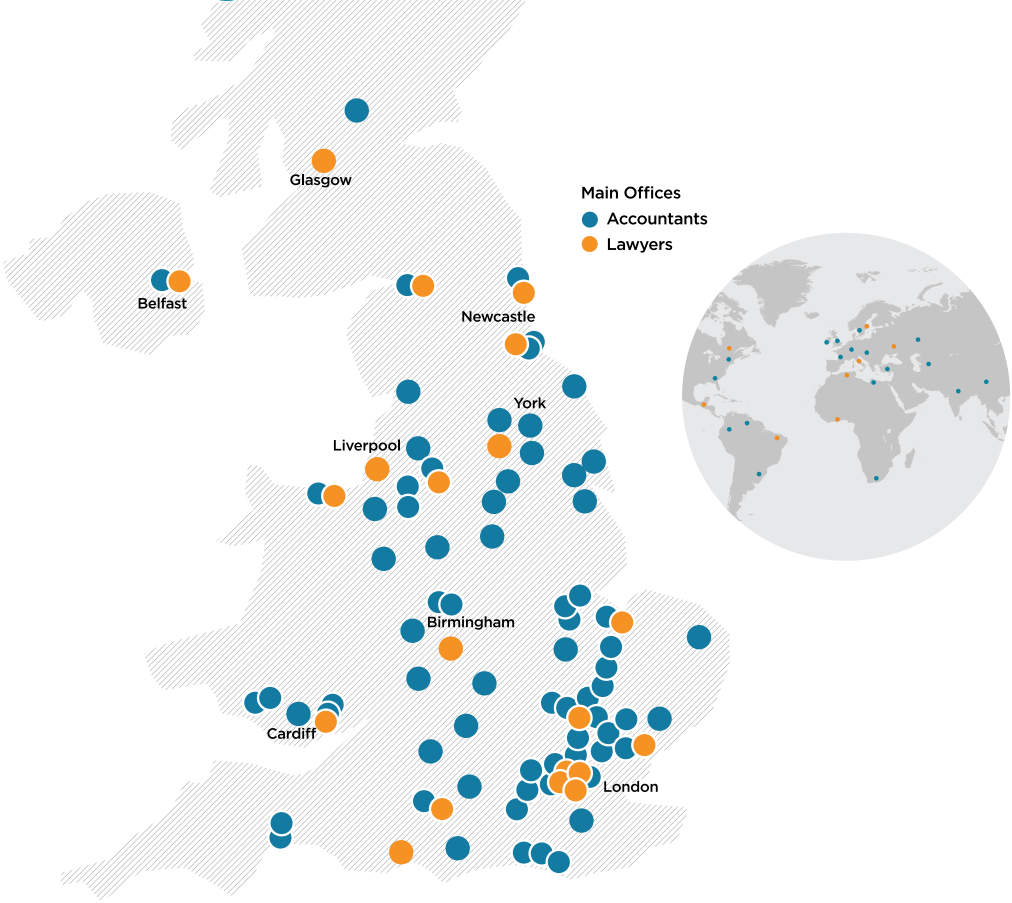
**Umbrella company:** A company that acts as an employer to contractors, processing payment and taking care of tax and administrative matters.

**Unique Taxpayer Reference (UTR):** A number that identifies you with HMRC for anything related to your personal tax obligations.

**Value Added Tax (VAT):** The sales tax levied on the majority of goods and services exchanged in the UK.

**VAT Flat Rate Scheme (FRS):** A scheme available to small companies, enabling them to pay VAT at fixed rate without subjecting them to the same administrative requirements.

# We've got it covered

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# Notes

# Notes

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