



# Secrets to Contracting

## A Guide for Contractors and Freelancers

Version 1.5

Get this document from  
[www.sumituk.co.uk/guides/guides\\_to\\_contracting.asp](http://www.sumituk.co.uk/guides/guides_to_contracting.asp)

**SumIT (UK) Limited**

PO Box 506

Milton Keynes

MK7 8JD

Registered in England No. 3639410

UK Tel: 0870 366 6365

UK Tel: 01908 649 895

UK Fax: 0870 160 2754

Email: [info@sumituk.co.uk](mailto:info@sumituk.co.uk)

[www.sumituk.co.uk](http://www.sumituk.co.uk)

# 1 Getting Started

## 1.1 What are your motivating factors?

Consider carefully the reasons behind your desire to work for yourself. Only when you have clearly and honestly established these will you have a basis upon which to measure whether your expectations can be met.

The two most common motivations are

Economic: The potential to earn substantially more money.

Personal: This may include aspects such as greater control over the type of work you do and the times at which you conduct it in.

## 1.1 Where do you start?

You need to establish:

- If there is a market for your services?
- If so, is the market large enough to offer sufficient opportunities of work?
- Is the work located where you are prepared/able to travel or reside?
- Does demand for contractors in your market outstrip supply? If not, you may find work harder to get and/or have to be less selective.
- Is the likely level of income sufficient for your needs?

There are a number of sources of information to help you answer these questions:

If you are currently working alongside contractors, talk to them. Try and establish how your skills rate against theirs.

Talk to Agencies. Again, existing contractors may be able to point you in the right direction.

Check the Internet we list a number of job finding sites on our web site [links page](#)

Read through advertisements in relevant trade media.

## 1.1 Making the decision.

Once you have gathered all relevant information, you can make your decision on whether to contract or not based upon your economic and personal criteria.

### 1.1.0 Economic criteria.

Consider carefully the following factors when making your decision:

- The earnings rate for the work you would be doing; normally expressed as £ per hour.
- The hours you are likely to work in a week and the potential weeks worked in a year. It may sound obvious, but it is unlikely that you will be monetarily better off if you only work 26 weeks in a year.

The hidden costs. Remember, if you are currently employed you may have a number of financial benefits provided by your employer such as: pension scheme, sick pay, life assurance, private medical insurance, company car, paid holiday etc. Contracting means you will normally have to pay for these yourself. As a rough guide, allow the following amounts as a percentage of your current salary for any benefits you currently have:

- Company pension scheme 10%
- Sick pay 2%
- Paid holiday 8%
- Other benefits are difficult to generalise.

Don't forget the costs of travel and equipment such as computers or specialist tools.

A point to keep in mind is that the only valid comparison is a Net Income position i.e. what you are left with in your pocket. This is because as a Contractor your gross income may be higher but your deductions (tax and National Insurance) may also be lower.

**IR35.** This Inland Revenue press release of April 1999 is now effectively law. It has a big impact upon the net income position of contractors who fall foul of the rules. Very simply, IR35 reduces the affected individuals' ability to reduce deductions from income such as tax and National Insurance.

You should familiarise yourself with IR35 and how/if it will impact upon you (see Section 3)

As an aid to making the economic decision, you can use our [Income Calculators on our web page](#).

### **1.1.0 Personal Criteria**

- Can you adapt readily to change, cope with travel or live away from home?
- Are you able to organise and motivate yourself?
- Can you easily and quickly work alongside new people?
- Are you able to give up the relative safety of a traditional employed position?
- If you have a family, can it cope with these considerations?

Contracting will mean a far greater self-reliance than being a traditional employee and the personal factors are as important as the economic ones.

Now, if you have decided to contract, you need to market yourself.

## **1.1 Marketing Yourself**

First, you will need to prepare your Curriculum Vitae. Your CV is your main marketing tool; so do spend adequate time preparing it. Your CV should be:

- Concise. A prospective client will read through large numbers of CVs for each position and will not look favourably upon a vast tome.
- Relevant. In the same vein, stick to information that is relevant to the jobs that you are applying for.
- Accurate. Do not be tempted to exaggerate the truth and avoid any third party who may advise you to do so.

Second, you need to get your CV in front of prospective clients. The simplest manner of achieving this is to go through Agencies. Here are some tips for choosing Agencies:

Select about 5 ranging in size and specialisation in order to optimise your exposure.

Try to meet the Agencies in person. This is to satisfy you of their professionalism and help to build a personal relationship.

Insist that you vet any prospective client the Agency is considering forwarding your CV to. This will avoid duplication and having to turn down unwanted positions.

Maintain contact. For obvious reasons, the Agencies need to be kept abreast of your circumstances. Conversely, if you cannot be contacted, then you risk missing out on a contract. A professional Agency won't indiscreetly contact you in any way that may compromise your current position.

The next part of the decision making process is the manner in which you will trade/operate as a Contractor. Connected with this is the type of support services that you will require, if any, and who should provide them. Examples of support services include accountancy, banking, legal advice and financial advice.

# 1 Methods Of Trading

## 1.1 Introduction

One of the principal reasons for the existence of the contracting market is the concept of the *disposable employee*. By taking on contractors, an employer has no requirement to:

- Administer and pay National Insurance (NI) and tax via the PAYE system
- Provide benefits such as sick pay, holiday pay, maternity pay, redundancy etc., some of which are statutory (see Working Time Regulations).
- Provide optional benefits such as pensions, life assurance, medical insurance etc.

The first issue, the reduction in NI payments, is a fundamental factor behind the introduction of the IR35 based legislation (see Section 3).

Further, an employer no longer has to pay for training costs to update redundant skill sets or continue to pay an employee whose abilities are not required for periods of time.

In many cases these factors combine to make it more cost effective for an employer to utilise the services of a contractor than a full time employee. The benefit to you is that some of these cost savings are passed on by way of the rates offered to attract contractors in the first place.

## 1.1 Evaluating The Options

In examining the various types of trading methods, you will want to make some quantitative comparison between the choices. Key aspects will be the ability to control the proportion of earnings you can keep and how soon you obtain them. When examining your trading options, consider the areas listed below:

<b>The level of income</b>	Gross anticipated income.
<b>Expenditure</b>	Can you claim back expenses you have incurred in the course of your work?
<b>Tax</b>	Are there planning options available to reduce your tax bill?
<b>National Insurance (NI)</b>	Can you lower your NI liability?
<b>Cashflow</b>	How soon will you receive income and if there are any further liabilities, how long can you defer paying them?

**Table 1 key comparative criteria**

### 1.1.0 Self-employment

Self-employment certainly offers plenty of scope for financial planning which ultimately means maximising your income. However, it is unlikely that this route will be available to you. Essentially, the Inland Revenue's definition of Self-employment excludes individuals working with one client as distinct from those having the capacity for multiple and/or concurrent clients.

If a client were to take on a self-employed contractor, it is likely that the contractor would be deemed an employee and the client would become liable for the employee costs that he was trying to avoid in the first place. Consequently this method of trading is rarely available as an option.

## 2.0.0 Employee/PAYE

You can become an employee, typically of an agency. This route has the following advantages:

- All of your tax and NI is taken care of for you.
- You may have the security of being paid by the agency during short gaps in employment.
- You may be entitled to employee benefits such as sick pay.
- The Working Time Regulations designed to protect employees will apply.

<b>The level of income</b>	You are likely to be paid the least under this manner because the Agency will be taking a % of the income you generate to provide you with the surety of pay.
<b>Expenditure</b>	Certain items of expenditure that cannot be claimed by a traditional employee may be allowed (subject to IR35) if trading via a Limited Company e.g. computers.
<b>Tax</b>	There is no scope for tax planning other than provided by traditional employment. Thus you will suffer the maximum deductions at source with no control over them.
<b>National Insurance (NI)</b>	You cannot control or reduce your National Insurance.
<b>Cashflow</b>	Cash flow may be prompt but reduced as the agency takes a percentage. The Working Time Regulations forces employers to give holiday pay to leavers. Therefore, your employer is likely to pay a lower income to cover this liability amounting to between 5 and 8%. There is no capacity for tax deferral.

**Table 2 key comparative criteria – PAYE**

The impact of the Working Time Regulations led to a substantial reduction in the number of Agencies prepared to operate this method.

### 1.1.0 Options Involving a Limited Company

There are three different ways of drawing income from a Limited Company and each method has different consequences:

- Salary/PAYE. This is identical to a traditional employee. Tax is paid up to 40%. National Insurance paid is up to 10% by employees and 12.2% for employers.
- Dividends can be paid to shareholders (the owners) of the company. The net tax position is largely the same as PAYE although the timing is different, generally aiding cashflow. However, **no** NI is payable resulting in savings of up to 22.2% on some income.
- Expenses legitimately incurred by the Contractor can be paid back without deduction of tax or NI (restrictions for those affected by IR35).

At this point it is necessary to make some introduction to **IR35 legislation**. This topic is dealt with in detail later but at this stage it is simpler to state that those trading under a Limited Company (or any other method) will fall into 2 camps:

- Those affected by IR35
- ... And those not affected by IR35

It is possible to be partially affected if you are engaged in more than one contract at the same time although this is an unlikely scenario for most contractors.

The impact upon your net income between the 2 is considerable and so it is hugely important that you make as accurate an assessment as possible as to whether you will fall foul of IR35.

**1.1.0.0 Umbrella Companies**

This is one form of trading under a Limited Company. One Company can have any number of contractors working beneath it and these “employees” are unlikely to be connected in any way.

This is the next step along the line from PAYE. Your tax and NI will be taken care of by the organisation running the umbrella. The introduction of the Working Time Regulations has eroded some of the savings made by an Umbrella provider in comparison with the PAYE method. This is because the regulations impose minimum employee benefits applicable to both PAYE and Umbrellas equally.

<b>The level of income</b>	Income should be higher than through the PAYE route because you are only going to be paid whilst you are working.
<b>Expenditure</b>	You can claim expenses.
<b>Tax</b>	The scope for tax planning is marginal.
<b>National Insurance (NI)</b>	You cannot draw dividends because you are not a shareholder. (See 2.0.0.0). Therefore, there is no potential NI saving.
<b>Cashflow</b>	Cashflow is probably going to be affected by the Working Time Regulations rules relating to holiday pay. This may result in up to 7.7% of pay being withheld. Alternatively, the charges for using the Umbrella could rise accordingly.

**Table 3 key comparative criteria - Umbrella Company**

There is an additional downside to Umbrella companies. If a Contractor working under the same umbrella as you commit an illegal or negligent act, then the Umbrella Company may have a claim made against it. In turn, this could easily lead to your income and the remainder of your contract being put at risk whilst the Umbrella Company is being sued.

The traditional Umbrella does not sit uncomfortably with the IR35 legislation because a key thrust of IR35 is to prevent NI avoidance via taking dividends: not an option with an Umbrella. It is worth noting that the cost of operating under an Umbrella is cheaper than outsourcing with your Own Limited Company (see below). Therefore, if you are IR35'd it would be probably be cheaper to operate under an Umbrella. However, this would expose you to the negligence risk highlighted above.

**1.1.0.0 A Limited Company of your own (non IR35)**

There are a number of variations on the theme of owning a Limited Company. Before looking at these different themes, examine some of the main advantages of having your own Limited Company.

<b>The level of income</b>	Income should be at least as high as any other route because no external party is providing you with any guarantees of income. Nor are you being provided with benefits of sick pay etc.
<b>Expenditure</b>	You can approve your own expenses.
<b>Tax</b>	You have great scope for tax planning. For example, if you have a spouse/partner whose tax rate is below yours, then making him/her a shareholder could save between 17% and 40% tax on some earnings.
<b>National Insurance (NI)</b>	You can draw dividends instead of salary saving you up to 22.2% in deductions on some of your earnings (because no NI is payable on dividends).
<b>Cashflow</b>	Cashflow is unaffected by the Working Time Regulations. Also, drawing dividends enhances cashflow because some tax will be deferred and can be earning you interest meantime.

**Table 4 key comparative criteria - Limited Company (non IR35)**

Try the Income Calculator on our web page to see how different strategies affect net income.

As you will see, IR35 is specifically designed to prevent as many contractors as possible from taking advantage of Tax and NI. Thus, if you are a victim of IR35, one of the principal benefits of contracting is effectively nullified: namely the ability to reduce deductions from your gross income. Remember from earlier that contracting offered 2 potential income advantages:

- Higher gross income
- The ability to reduce deductions of tax (by planning) and NI (by taking dividends)

IR35 leaves you with the first point alone. Therefore, from a purely economic perspective, the level of gross income needs to be higher to make it worthwhile contracting in the first place.

**1.1.0.0 A Limited Company of your own (IR35)**

<b>The level of income</b>	Income should be at least as high as any other route because no external party is providing you with any guarantees of income. Nor are you being provided with benefits of sick pay etc.
<b>Expenditure</b>	Expenses become more strictly defined in order to be allowable
<b>Tax</b>	Tax planning opportunities differ little from a permanent employee. One tool still available is to have pension contributions paid by your company effectively getting tax relief of up to 46.52%
<b>National Insurance (NI)</b>	You can draw dividends but you will still pay the tax and NI on the majority of income as if it were salary
<b>Cashflow</b>	Cashflow is unaffected by the Working Time Regulations. Income not drawn as salary will not be taxed (+ NI) until April 19 <sup>th</sup> after end of tax year.

**Table 5 key comparative criteria - Limited Company (IR35)**

It should now be patently clear that IR35 impacts heavily on the ability to reduce deductions from your income via your own Limited Company. Note that you can still take dividends for example, however you will still have to pay over the relevant NI at the tax year-end. So, is there any point in using this method of trading if you are affected?

Quite possibly by default it may be the only option open:

- Self-employment is unlikely to be accepted by a client. In any case, if you can meet the Revenue's criteria for self-employment then IR35 is not an issue to you anyway.
- Umbrellas still carry the risk associated with unconnected contractors working under one company.
- It seems fewer Agencies are prepared to take on contractors on an employed basis.

Therefore, if it is economically viable to contract under IR35, the Limited Company may be your default or still your best option.

## 1 IR35

### 1.1 The debut

IR35 appeared as a seemingly innocuous press release with the Budget of April 1999.

“This move underlines the Government's commitment to achieving a tax system under which everyone pays their (sic) fair share.” “It is possible for someone to leave work as an employee on a Friday, only to return the following Monday to do exactly the same job as an indirectly engaged 'consultant' paying substantially reduced tax and national insurance.”

Irrespective of the factual correctness of “reduced tax, the last line appeared to hint that this had nothing to do with the typical contractor. However, in keeping with typical governmental practice, this was a mountain masquerading as a molehill.

### 1.1 The reality

The truth was an entirely different matter. The Government was looking to raise revenue and wanted to ensnare as many contractors as possible. As a target, contractors had no real representative body (go to PCG <http://www.pcggroup.org.uk/> for such a body now) and largely constituted a mass of unconnected individuals.

Irrespective of any moral issue, contractors were working completely legally within the taxation system that this and previous Governments were responsible for creating.

No consultation was sought by the Inland Revenue, only discussion on implementation. In reality, questions raised which highlighted loopholes simply resulted in redrafting to close them, a kind of legislature open source.

IR35 became official as of 6<sup>th</sup> April 2000 and is enshrined via the Social Securities Contributions (intermediaries) Regulations 2000 and the Finance Act 2000.

### 1.1 The effect

Recall that operating via your own limited company potentially allows:

- Taking income as dividends thus avoiding paying National Insurance
- Utilising a spouse/partner's unused tax bands to reduce the overall household tax bill: by making him/her a shareholder and/or employing him/her.

If you are caught by the rules, then both of the above advantages become academic. In simple terms, your gross income is taken, 5% allowed as a concession to running the company and the remainder used to calculate a figure called the DEEMED PAYMENT.

From deemed payment you will be liable for:

- Employee tax
- Employee NI
- AND employer NI

Using the standard rules for calculating such liabilities.

As a consequence of paying Employer NI as well as Employee NI, higher rate (40%) tax paying contractors will in fact be paying a new marginal rate of tax = 46.52%.

*The potential impact upon net income between the affected and the unaffected is very considerable. It is vitally important that you accurately assess which side of the rules you will fall **before** you start contracting.*

**For comparisons see the Income Calculators at our web site.**

## 1.1 The measurement criteria

Clearly, in order to make any kind of assessment as to whether you are likely to be an IR35 victim, you need some benchmark criteria. What the Revenue is looking for is to see whether you are a “disguised employee” of the client. The Revenue is using a number of the traditional markers of self-employment. Of course, working through a Limited Company means you are employed: by your company. However, the Revenue seems to be creating a new class of employment using employee taxation but self-employment determining rules.

*This Guide is not a substitute for professional legal advice and should not be relied upon in making a decision on whether you are subject to the IR35 rules.*

It is strongly recommended that you visit the Professional Contractors Group at [www.pcggroup.org.uk](http://www.pcggroup.org.uk) and join:

- It is an invaluable source of information such as the latest state of play and advice on how best to minimise your chances of being affected
- The PCG is working on your behalf to rescind or relax the rules

Keep in mind that there will be little or no judicial precedent in the early stages of implementation and so there will be a lot of grey areas. The following points are some of the factors influencing the decision process. Some carry more weighting than others do. Each contract/engagement needs to be examined on its own.

### 1.1.0 Contract(s)

#### 1.1.0.0 *The contract between the client and the intermediary*

In the simplest scenario this is the client and your company. However, it could be the client and the agency & the agency and your Limited Company; where both contracts are relevant. It is important to make sure that the contracts are worded as favourably as possible (within the law).

Again, the PCG has examples of how to correctly word the contracts. You may find that it is the Agency rather than the client who is unwilling to play ball here. If so, get another Agency and tell everyone who will listen.

However, the contract is not the final word if it doesn't genuinely reflect the real situation. Then the following “badges of trade” become important.

### 1.1.0 Substitution

Are you permitted to substitute another worker (at your expense) to effect the work? The other extreme is that the contract specifically names you to conduct the tasks. Clearly, anything approaching the former is likely to help your cause.

This particular criterion carries a relatively high weighting.

### 1.1.0 Remuneration basis

Are the payment terms on a per hour/per week/per month basis OR is it a fixed sum? For example, with the latter there may be a specific piece of work agreed to be completed at a set cost. If it takes longer than expected you lose out financially; alternatively if you deliver early then you benefit.

This is an indicator that you are taking risk.

### 1.1.0 Working control

Who exercises control over what, where, how and when the work is done? Two extreme examples might be:

- A consultant visiting client sites at his discretion, completing work to his own schedule, reporting the results to the client.
- A programmer working at a client site, under control of a manager, working as part of a team with employees of the client and in 9-5 hours.

Clearly, the first scenario is better than the second from an IR35 perspective.

### **1.1.0 Financial Risk**

“We would take account of a substantial investment in skills, where a skilled worker incurs significant expenditure on training to gain a skill, which will be used in subsequent engagements. This kind of investment can be treated as a pointer to self-employment in the same way as investment in tools or equipment.”

However there is no indication if skills gained prior to April 2000 count. Further, no indication is given to how long after acquiring them that this factor counts.

In many ways, this highlights the uncertainties. Cynically, one could view the rules as being deliberately vague so as to allow whatever interpretation is deemed favourable to the Government.

Included in this risk could be purchasing assets for your business.

### **1.1.0 Tools and equipment**

Who supplies the tools? For example, working on a client’s network computer at the client’s site is not favourable.

### **1.1.0 Engagement length**

The longer the period of engagement with the same client, the more this points to IR35 victim. It is unlikely that many short contracts with the same client will be viewed significantly differently to one long one of equivalent length.

### **1.1.0 Termination**

Can the contract be terminated for reasons other than non-performance?

### **1.1.0 Employee benefits**

It goes without saying that attending staff social functions or being provided with staff facilities such as a gym will reinforce the impression that you are a “disguised employee” of the client.

## **1.1 Optimise your chances of escaping IR35**

There are a number of steps to employ to give you the best fighting chance.

- Some people will categorically be unaffected by the nature of their work. However, it wouldn’t hurt to be doubly sure.
- Make sure the contract wording is as favourable as possible. Remember, if you are contracting via an Agency, the contract between the Agency and the client is equally as important as that between your company and the Agency.
- Seek professional advice and talk to other contractors in similar roles.
- Check out the PCG at [www.pcgroupp.org.uk](http://www.pcgroupp.org.uk) for lots of valuable information.

## **1.1 Make the right decision**

If you are thinking of taking the step into contracting from a permanent position, now more than ever you need to take a pragmatic stance. If you are unsure, assume the worst and look at the income position from that view.

## **1.1 Play safe with your money**

Due to the uncertainties, there will be a lot of contractors who will not know whether they will be affected. If you have decided to contract, because in the worst-case scenario you are still better off, then play safe:

- Keep enough money back to cover the maximum possible tax and NI liability at the end of each tax year.

The settlement of the liability is to be made on 19<sup>th</sup> April following the end of the tax year.

## 1 Different Approaches To Using A Limited Company

There are four readily distinguishable options on offer to you in the market:

### 1.1 DIY

You purchase a Limited Company and do all the administration yourself, possibly utilising an accountant for the annual accounts. This is considered to be the cheapest approach but will involve plenty of work and responsibility yourself [see 5 below]. If you are not happy with the cost in terms of time involved or the responsibility of the tasks, then this is not the route for you.

### 1.1 Assisted

You purchase a Limited Company and pay a fee to a Service Practice to provide guidance on the Operating Procedures. This guidance can vary in the level and type of support provided and consequently, the cost. When considering this approach, be very sure that you are making valid comparisons because it is very easy for the unwary to be misled. Obtain detailed listings of what you are actually being provided for your money.

*The remaining 2 options appear very similar and essentially involve outsourcing the administration of your company.*

### 1.1 Director, Company Administration Outsourced

A Service Practice provides you with a Limited Company but undertakes most of the work listed in Operating Procedures [5] for you. This ranges from invoicing and collecting your money to filing all necessary returns to the relevant authorities. *You own* all the shares in the company (along with anyone else you elect e.g. spouse/partner) and therefore *you own* the company; this enables you to draw dividends. You are also the registered Director, the value of which will become apparent.

### 1.1 Non-Director, Company Administration Outsourced

This option is very similar to 3.0 but with the exception that you are **not** the registered Director of your company; the Service Practice is.

### 1.1 What Are The Differences Between Options 3.0 And 4.0

Understanding the difference between 3.0 and 4.0 *is extremely important*. As previously stated, the difference is that with option 4.0 you are **NOT** the Director of your own Company.

So what if you are not the Director of your own Company?

- You may remember that with Umbrella Companies, there was the danger that an unconnected contractor could create a legal liability and hence threaten the income of other contractors through a negligent act. There is a similar danger with a Service Firm being the Director of your Limited Company. If it does something sufficiently negligent, it could become a disqualified Director leading to problems for **all** the companies for which it acts as a Director.
- You will pay National Insurance in the same manner as an ordinary employee. Compare this with Directors. There are special rules relating to Directors NI contributions. It may be possible for Directors to avoid paying unnecessary National Insurance if they are able to draw a small salary throughout the tax year, as there is an effective lower earnings limit<sup>1</sup>. This 'nil allowance' may simplify NI administration and is an important issue if you choose to get involved in the administration yourself.
- There is a question over ownership of company assets such as the bank accounts. Keep in mind that the money held here will probably amount to thousands by the end of a tax year. If you are the Director, the interest earned from money awaiting payment to you or the tax authorities definitely belongs to you.

Technically, the Service Firm has considerable power over you because your contract with them is only as an employee whilst it is the Director. Therefore, you would be obliged to meet any reasonable request it made of you to fulfil work such as the client and/or location.

---

<sup>1</sup> NonIR35

## 1.1 SumIT view

At **SumIT** we feel that it is inadvisable for any Contractor not to be the Director of his/her own company. Ask yourself if you can think of any companies (large or small) that hand over their Directorships to their practice accountants?

The only possible advantage to you of not being a Director of your own Company is that you avoid the legal responsibilities of submitting returns to the authorities. However, if you feel your accountants are going to get this task wrong (the job you are paying them for), why are you using them in the first place? Further, the Company Secretary has largely the same legal responsibility for correct returns as the Director **but** has no specific powers. The FreeTime service operates with SumIT (Company Secretary) as the company's Secretary. Therefore, SumIT carries legal and contractual responsibilities *but you remain in complete control* over your Company.

In short if you are not a Director you are not in total control!

## 1.1 SumIT Services

At SumIT our principal service is **FreeTime** and reflects 3.0. We would recommend FreeTime to Contractors without accountancy experience or for anyone who does not wish to be burdened by the administration involved

- Time
- Responsibility
- Cost

We will consider offering partial assistance services (2.0) on an individual basis. In practice, this is not a popular option with the majority of contractors electing to go DIY or fully outsourced.

# 1 Operating Procedures

## 1.1 What are the administrative duties involved in running a Limited Company?

The following is not a Beginners Guide to running your own company. It is simply an indicator of what is involved. This should help you decide the level of involvement you are prepared to or would like to have.

### 1.1 SumIT Services

To a large extent the SumIT FreeTime service takes away the administration. With FreeTime we do the majority of this work for you.

### 1.1 Setting up

- A company can be purchased from Companies House (the cheapest option) or “off the shelf” from any number of providers (including SumIT). You will receive a Certificate of Incorporation giving you a unique identification number and the name of your company.
- You will need to draft and register Memorandums and Articles of Association. Broadly, these are the rules by which your company is run. There are legal restrictions and compunctions involved.
- You have to choose a name for the company which cannot already have been used. It may not be misleading or offensive.
- The company must have a registered office, which will determine aspects such as the Tax Offices dealing with the company’s affairs.
- Although one person can own a company, the practical minimum number of people involved is two because the Director and Secretary cannot be the same person.
- Resignations or appointments must be notified to Companies House on the correct forms.
- You will need to decide how many shares the company may have (authorised capital) and how many you require at outset (issued capital). If you sell shares you need to complete and register appropriate paperwork.
- The Accounting Year End needs to be decided. This is the date dictating when the company’s accounts need to be submitted and does not have to coincide with the Fiscal Tax Year. The choice of this date can affect your tax planning.
- If appropriate, VAT registration needs to be undertaken.
- Prior to paying you a salary the company needs to set up a PAYE scheme with the correct tax office.
- You will need a business bank account. The bank will require various forms of identification including the Certificate of Incorporation and will conduct certain searches.

## 4.0 Running

- Tax and National Insurance returns need to be made for your salary. This is normally done either monthly or quarterly.
- Correct authorisation procedures have to be undertaken in order to pay dividends as well as the completion of pertinent paperwork.
- Correct quarterly VAT returns are to be made based on all applicable transactions. You would need to choose whether to account for VAT on a “cash basis” or an “accruals basis”.
- It is a requirement that comprehensive, correct and proper records are maintained for a minimum of 6 years from the end of each company accounting year. These records must be available for inspection by any authorised bodies.
- If turnover exceeds £350,000 then an independent audit of the accounts is required by a qualified auditor.
- An Annual Return must be made to Companies House that includes details such as changes in the company’s structure.
- Completion and submission of the Corporation Tax Return.
- Annual General Meetings need to be held. These should be correctly minuted in the company’s Minute Book.
- Stationery. Varying details such as the company’s name, registered office address, registration number should appear on cheques, invoices, business letters etc. If one Director’s name is shown than all must be shown.

This is a brief summary of some of the duties and responsibilities involved in running a Limited Company.

### 1.1 Additional

- Personal Tax Return (Self Assessment). It is now a legal requirement for individuals to submit a *personal* tax return each year. This is a separate issue to those listed in 1.0 and 2.0 above, which are all *Company* related requirements.

## 1 Allowable Expenditure

If you have your own Limited Company, it is possible to offset expenses that are incurred 'wholly and exclusively' for the purpose of running the business. These are allowable deductions against the company's profit resulting in the company owing less Corporation tax. Below is a list of typical allowable expenses. It is by no means exhaustive so if you are not sure, please ask. *All expenditure should be backed up with receipts and invoices in the company name.*

- Stationery, computer consumables and postage
- Trade magazines and journals
- Business related courses and training
- Equipment rental, maintenance and repair costs
- Telephone (excluding domestic phone rental)
- Professional fees e.g. legal, accountancy, company secretarial
- Business insurance
- Bad debts
- Use of home as an office. It is permissible to charge the company an amount to cover a share of rent, heating, lighting etc.

For the IR35 affected, if the expenditure is such that it would have been allowable as a traditional *employee*, it will still be allowable under your own Limited Company. However, *Company* allowable expenditure is restricted to 5% of gross income. Be careful because the following things would be deemed to be part of the 5%:

- Accounting fees
- Spouse/partner's salary
- Spouse/partner's pension payments

Where employed in administrative or secretarial capacity as opposed to working with clients in own right to generate income.

Under IR35, it's fairly easy to exhaust the 5% allowance particularly for lower levels of gross income (e.g. 5% of a £30k contract is considerably less than 5% of a £150k contract)

### 1.1 Benefits in Kind

A Company may provide an employee with certain benefits in kind. Although these are allowable against the company's profits you, as an employee, may be taxed on them. Typical examples of these include

- Accommodation. If you have to move or live in temporary accommodation in order to take up a new position there may be a way of recouping some expenditure depending on the individual circumstances.
- Medical and Permanent Health Insurance provided by the company
- Subscriptions to Professional Societies e.g. British Computer Society

Most Benefits In Kind are subject to Employers National Insurance (11.8% as of 6<sup>th</sup> April 2002).

### 1.1 Expense payments made to employees and directors

Below are examples of expenses that may be claimed by a company employee. This type of expenditure is different to the above because the Inland Revenue consider them to be potentially taxable remuneration unless it can be shown that they were incurred 'wholly, exclusively and necessarily' in the performance of the duties of employment. Clear records need to be kept and both the employer (your company) and any employee must declare such expenses on the appropriate tax returns:

- Travel and subsistence - where it is clearly for business purposes e.g. meetings. Daily travel will only be allowed if the Revenue is satisfied that this was temporary and not to a 'regular place of work'.
- Business entertainment incurred by an employee may be reclaimed from the company but the company cannot offset this type of expenditure against profit nor reclaim VAT.

Mileage claims are allowed but you should keep a detailed record of business miles. Fixed rates have been calculated to take into account car insurance, wear and tear and depreciation in value of the car due to business motoring. From 6<sup>th</sup> April 2002, the rates change to 40 pence per mile for the first 10,000 miles and 25 pence per mile thereafter, irrespective of the engine size of the car.

### **1.1 Fixed Assets**

These are items purchased by the company where the company will benefit from its use over a period of time. In these instances the expenditure cannot be offset against the company profit but will probably qualify for capital allowances. The typical examples that your company is likely to need are computers, printers, fax machine. Note that if the equipment is sold on at a later date then there may be a charge made against any allowances received.

From 6<sup>th</sup> April 2000, if you are a small or medium sized company you are allowed to write off many IT related equipment purchases at a 100% against your company's profit in the year of purchase.

### **1.1 Expenditure Not Allowable**

Certain expenses that cannot be claimed against Company profits. These include Company formation costs, private expenses and fines. If you are not sure whether you can claim certain items then feel free to ask.

If you are in doubt about any of these issues, then please ask for advice.

## **1 Insurance Requirements**

In the course of operating a Limited Company the need will arise for various types of insurance. This may be a result of legal requirements, a stipulation by a client or the simple fact that you may feel it to be prudent.

### **1.1 Employer's Liability Insurance.**

Every employer and hence every Limited Company transacting business in the UK must have Employer's Liability Insurance. Its purpose is to protect employees who may sustain injury, illness or incapacity as a consequence of their employment. It is a legal requirement and cover normally ranges from the minimum £5 million to £10 million. There is no legal exemption even if the employer and employee is the effectively the same person.

### **1.1 Public Liability Insurance.**

Whilst not being a legal requirement, it is becoming increasingly common for clients to require this cover as a condition of the contract. The insurance protects your Limited Company for claims made by third parties for personal injury or damage/loss of property.

### **1.1 Professional Indemnity Insurance.**

PI cover is designed to cover claims brought about where a failing has resulted in economic loss to a client. The IT industry is unusual because in most professions Negligence Laws would be used when any claim was made for *errors*. However, in IT it is possible that Contract Law would be relied upon. This could arise in situations where any claim was for software failure because it would appear that the law treats the supply of software as "goods" (St. Albans City & District Council v ICL). Whilst PI cover is not a legal requirement, any persons working with software should take care that specialist advice is obtained if they are wishing to protect themselves.

### **1.1 Product Liability Insurance**

This covers claims made as a result of injury or damage/loss of property from goods supplied, repaired or tested. There is an overlap in IT with PI cover (see above). Product Liability is not a legal requirement.

Be aware that although Agencies have insurance of their own, they will not protect you. Whilst some types of insurance may not be a prerequisite, you need to assess the risk of any claim being made in the light of the type of work that you are involved in. It is worth remembering that even an invalid claim made against you may result in hefty legal costs.

### **1.1 Travel Insurance**

If you are going to be travelling regularly then it makes sense to obtain annual travel insurance, there are plenty companies offering this sort of thing and if you get the right cover it will cover you for vacation as well.

## **8 SumIT services**

### **1.0 FreeTime**

SumIT's **FreeTime** package allow you to enjoy the financial benefits associated with trading as a Limited Company, but without the drawbacks and worries of the administration

### **2.0 BootStrap**

BootStrap is a service for Contractors looking to trade via a Limited Company and require help in setting themselves up to trade but don't require ongoing assistance.

### **3.0 Formation**

Formation simply allows you to purchase your own new limited company to do with as you wish.

Full details including current costs are available at our website [www.sumituk.co.uk](http://www.sumituk.co.uk)

## **9 Copyright Notice**

No part of this publication may be reproduced, transmitted, transcribed, stored in a retrieval system, or translated into any human or computer language, in any form or by any means, without the express written permission of SumIT (UK) Limited.

Permission is granted for individuals to download and use a single copy of this document for non-commercial uses.

Permission for use by commercial organisations may be obtained by contacting SumIT

# 1 Table of Contents

1	Getting Started .....	2
1.1	What are your motivating factors? .....	2
1.2	Where do you start? .....	2
1.3	Making the decision.....	2
1.3.1	Economic criteria.....	2
1.3.2	Personal Criteria.....	3
1.4	Marketing Yourself.....	3
2	Methods Of Trading.....	4
2.1	Introduction.....	4
2.2	Evaluating The Options .....	4
2.2.1	Self-employment .....	4
2.2.2	Employee/PAYE .....	5
2.2.3	Options Involving a Limited Company .....	5
3	IR35 .....	8
3.1	The debut .....	8
3.2	The reality .....	8
3.3	The effect .....	8
3.4	The measurement criteria.....	9
3.4.1	Contract(s).....	9
3.4.2	Substitution.....	9
3.4.3	Remuneration basis .....	9
3.4.4	Working control .....	9
3.4.5	Financial Risk.....	10
3.4.6	Tools and equipment .....	10
3.4.7	Engagement length.....	10
3.4.8	Termination .....	10
3.4.9	Employee benefits .....	10
3.5	Optimise your chances of escaping IR35 .....	10
3.6	Make the right decision .....	10
3.7	Play safe with your money.....	10
4	Different Approaches To Using A Limited Company.....	11
4.1	DIY.....	11
4.2	Assisted.....	11
4.3	Director, Company Administration Outsourced.....	11
4.4	Non-Director, Company Administration Outsourced .....	11
4.5	What Are The Differences Between Options 4.3 And 4.4.....	11
4.6	SumIT view.....	12
4.7	SumIT Services.....	12
5	Operating Procedures.....	13
5.1	What are the administrative duties involved in running a Limited Company? .....	13
5.2	SumIT Services.....	13
5.3	Setting up .....	13
5.4	Running.....	14
5.5	Additional .....	14
6	Allowable Expenditure .....	15
6.1	Benefits in Kind.....	15
6.2	Expense payments made to employees and directors.....	15
6.3	Fixed Assets.....	16
6.4	Expenditure Not Allowable .....	16
7	Insurance Requirements.....	17
7.1	Employer's Liability Insurance. ....	17
7.2	Public Liability Insurance.....	17
7.3	Professional Indemnity Insurance. ....	17
7.4	Product Liability Insurance.....	17
7.5	Travel Insurance .....	17
8	SumIT services .....	18
8.1	FreeTime .....	18
8.2	BootStrap .....	18
8.3	Formation.....	18
9	Copyright Notice.....	18
10	Table of Contents .....	19