

Becoming a contractor

If you are thinking of moving from employment to contracting or freelancing, then you will need to decide how you are going to structure your trade.

Your clients will not want to trade with you if you are self-employed, so there are in reality only two options – working through an umbrella company or forming your own limited company. Whilst it may seem confusing, the reality of how to choose between these two options is really quite simple and here we'll give you a simple guide to the alternatives.

One word of warning before you go any further. Be careful of “employment services” companies that offer to set you up a “Personal Service Company” or offer you a scheme where they purport to have made some special deal on allowable expenses with the tax office. HMRC have made it clear that they are focussing on these scheme companies and there have already been very costly tax cases settled in HMRC's favour.

Umbrella Company.

In essence, you will become an employee of the umbrella company, and it is the umbrella company that has the contract with your client. You will be able to claim some limited expenses (the same sort of expenses that you claimed when you were in permanent employment) and you will pay PAYE and National Insurance on your earnings and a fee to the umbrella company.

You will not have any control of your own money, and will have to rely on the umbrella company to handle the paperwork and give you your salary. You will not be able to use the Flat Rate VAT scheme so the VAT costs that you pay will be higher, and hence, your income will decrease even further.

Your umbrella company will handle the bulk of the paperwork but you will have to file timesheets and complete monthly expense claims with receipts. Typically, as an employee of the umbrella company you will take home between 60% and 65% of the gross earnings.

Limited Company.

It is important to emphasise that the company must be genuine, it cannot be a pseudo company invented by an employment services company.

Working with your accountant at RiverView Portfolio, we will advise you on the structure of the company and form it for you, and we can introduce you to a bank and insurance company to complete the process. You will have a small amount of additional paperwork to do such as sending your sales invoice (we will give you a template), and you will control the bank account and have to make occasional payments to the tax office (we'll tell you the amount and payment details).

The Company will be able to claim many more expenses which of course reduces your tax liability, and you will be able to save a lot of money by using the Flat Rate VAT scheme.

Typically, if you trade through your own Limited Company, you would expect to take home between 75% and 80% of the gross earnings.

If you're ready to take the next step to becoming your own boss, decreasing your tax liability and increasing the cash in your pocket, give the accountancy team a call at any of our offices.