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**Contractors guide**

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# What is contracting?

Contracting means working for somebody else, for a fixed period of time, in order to help them to complete a project. Contractors are usually paid on an hourly or daily basis. The lifestyle of a contractor is very different from an employee as it includes more risks but advantages too.

## Advantages of Contracting

The demand for contractors has been growing over the last few years & is considered as a choice for many people. The most common reasons why people choose contracting as an option are given below–

- Freedom – Contractors are considered their own boss due to the freedom to choose when & where to work, when to take holidays etc.
- To earn more money – Contractors usually earn more than an equivalent permanent employee, which can be very satisfying.
- Tax planning – A contractor taking good professional advice can reduce their tax liability.
- Variety of options – A contractor can benefit from working in a number of contracts & companies, which increases his experience, and helps him develop an impressive CV which makes him stand out from the crowd and hence more desirable for future positions.

## Disadvantages of Contracting

Before becoming a contractor, it is not fair to consider only the advantages of contracting as contracting does have a few disadvantages too. However, as per client's feedback, contracting advantages overshadow the disadvantages. Some of the disadvantages are as follows –

- Little legal security – Contractors are given less protection in comparison to permanent employees. If a contractor thinks that contracting is not the right choice, then he or she has the option to close the company and return to permanent employment.
- No employee benefits – A Contractor no longer has access to employee benefits like sick pay and holiday pay. The higher earnings of being a contractor should cover this deficit.
- High uncertainty – Contractors are responsible for finding their own contracts so there is a level of uncertainty about where the next contract is coming from. However, recruitment agencies and the free alert facility do make work easier for the contractor to find.
- Additional administration – As a director of your own limited company, or even just as owner of a sole trader business, there are many things which you have to do including form filling, obeying rules & maintaining accounts. Hiring a good accountant will reduce the burden and the potential stress levels.

# IR35

Intermediaries' legislation or 'IR35' as it's commonly known is a set of anti-avoidance rules that were introduced in April 2000, to prevent disguised employment. It was designed to stop contractors, who worked through their own limited companies, but would otherwise be classified as employees, from gaining the tax benefits associated with working in this way.

Prior to these rules, a worker would resign from his employment on Friday and return on Monday to the same role in the same company but as a contractor. The only difference being he is now employed by a personal service company of which he is a controlling shareholder and director.

By providing services through their own company, the worker could avoid national insurance contributions and minimise his tax liability by paying himself through a combination of salary and dividends. The original employer on the other hand could avoid paying Employer's NI, thus saving 13.8%. IR35 rules were implemented to deter such activities, by removing the tax benefits.

As a contractor it is imperative that you are aware of IR35 legislation, as it affects everyone in the contracting business. In a nutshell, IR35 legislation tries to tax your company income as employment income meaning that almost all of the tax advantages gained will be lost if you fall foul of IR35.

## How IR35 affects you

Firstly, as a contractor, every contract, needs to be reviewed as to IR35 status i.e. whether it is caught by the IR35 legislation or not.

If your contract is caught within the legislation, then you can end up paying 25% more in tax each year as you can no longer operate, and hence benefit, by working through your own personal service company and paying yourself a minimum salary and taking the rest through dividends.

Hence it is to your advantage to make every effort to ensure all your contracts and working practices are outside IR35. You should review all your contracts, but your end client may be the one making the final judgement, or even HMRC if you get an enquiry, so do keep notes. It's imperative for Contractors to work and behave like contractors and not employees and therefore the working practices of a contractor should be those of a contractor.

Under standard IR35 rules you/your company needs to make this review and judgement; and if caught then you will be required to draw 95% of your income as remuneration and pay tax the same way as an employee.

Under new off-payroll rules (from 5th April 2017) publicly funded users of contractors need to make this review and if they assess the contract as caught by IR35 rules then they or their agents will deduct the taxes as if the contractor were an employee.

From April 2020 some larger private companies who use contractors may also have to make the review and deduct the taxes.

## Off-Payroll working

The responsibility for reviewing contracts and applying taxes under IR35 had been wholly on the worker and their personal service company. However, in April 2017 this changed. Off-payroll working rules were introduced for those contractors working in the public sector. These reforms changed the responsibility for determining whether the IR35 rules should apply, also for calculating and paying over the resulting tax.

Please note that the judgement criteria have not changed with these new rules, and workers have not been given new employment rights.

There are plans to extend these reforms to large engagers in the public sector, from April 2020.

## What's my IR35 status?

Unfortunately, there is no clear definition on what constitutes employment or self-employment, just indicators that should be used to take an overall impression; hence many IR35 cases are referred through the employment cases that developed these indicators. The Ready Mixed Concrete Case (1968) laid the fundamentals for what constitutes employment and it was established that for employment to exist, there must be three conditions:

Personal Service

Is there a requirement for the worker's personal service?

Control

Is there a sufficient degree of control over the worker?

Mutuality of Obligation

Are there mutual obligations of the contract consistent with employment?

Why are these three conditions so important? Because if the answer to any of these questions is 'no', then the contract cannot be of an employment and the worker can be termed as self-employed.

There are various other secondary factors which may be considered when deciding IR35 status but the point to be remembered is if any part of the irreducible minimum is not present, and then the relationship simply cannot be one of employer and employee.

## IR35 determination factors

Here are the factors that should be considered when reviewing IR35 status. IR35 status should never be determined by one criterion alone, it is determined by the overall working relationship between the contractor and the end user. In the case of enquiries your working practices will be examined along with the contract – it is therefore important to ensure your working practices are consistent with those mentioned in the contract and you are running a genuine business.

## Personal service & substitution

There will be no requirement of personal service if a contractor has an unfettered right to substitute or subcontract the services to a third party. This is because unlike employment, where an individual is required to carry out a role; the contractor has the right to send someone else to do the work implying she/he is self-employed.

## Control

Under an employment contract the employee is told what needs to be done, where it needs to be done and how it needs to be done. In a self-employment contract it is reasonable to assume that there will be a job description outlining the services required; where the services need to be performed but if the contractor is told how the services need to be performed then it may indicate employment. So, if the contractor has autonomy over the working methods or how the services are delivered and cannot be moved from task to task as the client's priorities change; then he may be termed as self-employed.

## Mutuality of obligation

Although this is one of the conditions which the Revenue disregards completely, the presence of mutual obligation between the parties is essential for employment to exist. An employee is usually provided with continuous work and is expected to complete the work provided implying MOO exists. If in a contract there is no obligation for the client to offer further work during or after the assignment and the contractor is not obliged to accept further work if offered, it would mean no MOO exists between the client and the contractor indicating self-employment.

## In business on own account

An employee is working for someone else's business, and a self-employed worker is working for his own business. This is a fundamental question for HMRC, but not necessarily so easy to answer for a professional.

## In business factors

So, what indicates that someone is in business? Things that the ordinary employee does not do:-

- Advertising & marketing to get work
- Preparing estimates, quotes, invoices to get paid
- Having a separate business name, phone number, website
- Employing staff to do admin etc.
- Having a separate business premises
- Their own insurance

## Financial risk

Those in business take financial risks e.g. they set costs for their products and services etc. and their profit or loss depends on their capacity to reduce overheads and organize work effectively. An individual who risks his or her own money investing in assets needed for the job and pays their own running costs and overheads is, most probably, self-employed. For a contractor this can be more difficult to demonstrate. What is meant by financial risk is that you may be required to correct your mistakes, and for that you will not be paid any money. A contract may require you to have professional indemnity insurance to cover the consequences of this eventuality.

## Basis of payment

Independent contractors tend to be paid a fixed sum for a job. Employees on the other hand are paid a fixed wage or salary weekly or monthly and often qualify for additional payments such as overtime or a bonus. If you are being paid by the hour or by the day then that is how an employee is paid, according to HMRC. However, it is what you are being paid for that counts. An employee is paid for being there; hence they are paid by the hour. However, a contractor is paid for undertaking a project, and that project could last 10 minutes or 10 years. A contractor could be paid a fixed fee or an hourly/daily rate for their input to that project in that period. Be clear what the project is that is being worked on.

## Involvement

If you are behaving like an employee, for example you regularly attend staff meetings, submit holiday request forms or enjoy staff functions and you are strongly involved in the clients business on a day to day basis, then this might well indicate IR35 status. In fact, if you are actively involved in the decision-making processes of the company, much like a non-executive director, then this work falls under IR35.

## Exclusive service

If you are working on more than one project simultaneously and they are of equal importance and value, then it might help to establish that you are acting in the capacity of a business. But this is still not conclusive evidence as each contract is assessed separately. However, an exclusive contract that prevents you from doing this can indicate employment.

## Flexible working

This may be a minor factor but in the overall picture, it helps in determining whether or not you fall outside or inside IR35. Employees are usually expected to work at client premises, at given times and ask for time off for holidays etc. and provide sick notes. A contractor should have the flexibility to determine their own working hours, and if they can choose to work from home then this is a good indicator that IR35 rules do not apply.

## Right of dismissal

In a service contract there is no right to terminate an engagement by giving notice of a specific length, which is a common feature of an employment contract. A service contract usually ends when the task is complete or if the contract is breached.

## Equipment

A self-employed worker is expected to bring his own tools and knowledge to the job. An employee is expected to be provided with all the tools and training required, An IT contractor engaged to undertake a specific project and who works exclusively at home, using his or her own computer equipment will have a strong indicator of self-employment. But a worker who is provided with office space, and computer equipment suggests employment. There are exceptions, for example in the case of health and safety, specialist or expensive equipment, or security, which can make this a minor factor for some contractors.

## Intention

The reality of the relationship matters, it is not enough to call a person "self-employed" if all the terms and conditions of the engagement point towards employment. However, if other factors are neutral, the intention of the parties will then be the deciding factor in employment issues.

# Contracting routes - options

Once you have decided to go contracting, or become a freelancer, then you must choose your route. The main two routes are Limited Company and Umbrella Company, however for completeness here are the full options.

## Agency Worker

For a short one-off contract or to see if this is the type of work for you, you may choose to work as an employee of an Employment agency (A recruitment / placement company)

### Advantages

- No admin for you to do
- No need to save up money for your taxes – as all is paid up front

### Disadvantages

- You are not in control
- Few if any expenses are allowable
- No flexibility in how to pay yourself
- No tax benefits of paying low wages and top up with dividends
- May be costly in agency fees
- Full employment rules apply to the agency after 13 weeks so they may not want to keep you longer

## Sole Trader

Many contractors successfully work as sole traders, usually if they work for the general public where IR35 rules do not apply. However, if you have contracts that are caught by IR35 then you cannot operate as a sole trader for those contracts – you will be an employee.

Hence if you get your work via agencies or recruitment agents then you are unlikely to be allocated contracts as a sole trader.

If you want to keep things simple and cost effective, intend not to involve any partners or employees and want to handle the business single handedly, then to be Sole Trader may be the best option going forward. It is also simple and easy in terms of paperwork. However, make sure that your business has little risk as you carry unlimited liability as a sole trader.

### Advantages

- Simple & cost effective

### Disadvantages

- Loose work from agencies or customers worried about IR35
- Personal risk as you carry unlimited liability
- Fewer tax allowable expenses than a limited company
- Less flexibility – all income and hence tax is yours today

## Partnership

A business partnership is very like a sole-trader but you have others involved. It may be set up to run a traditional business or for contracting.

A business partnership can be a great idea, you share the journey and its ups and downs including responsibility, liabilities and profit. But as with any partnership, the big question is how to make it work? Or at the very least, how to avoid the worst pitfalls?

Contracting is usually a very personal service you are providing and hence a contracting partnership has few tax advantages and all the disadvantages of the sole trader contractor.

### Advantages

- Simple & cost effective (unless an LLP)
- Ability to share income with other partners

### Disadvantages

- Loose work from agencies or customers worried about IR35
- Personal risk as you carry unlimited liability (unless an LLP)
- Fewer tax allowable expenses than a limited company
- Less flexibility – all income and hence tax is yours or your partners today

## Limited Liability Partnership

Some protection may be achieved by setting up a Limited Liability Partnership (LLP) however you then lose some of the advantages of privacy and simplicity, and gain the disadvantage of statutory obligations as regards accounts preparation and filing.

### Advantages

- Ability to share income with other partners

### Disadvantages

- Fewer tax allowable expenses than a limited company
- Less flexibility – all income and hence tax is yours or your partners today
- Rules and deadlines – for accounts at Companies House
- Lack of privacy – details on public record at Companies House

## Limited Company

A limited company is a type of business structure, which is incorporated into a legally distinct body. If an individual opts to run the business as a limited company, the business will

- be legally distinct from the person responsible for running the business;
- maintain separate finances for both business and personal finances; and
- own assets.

Contracting to businesses via a personal service company has been a very tax efficient and popular way of working for many years.

### Advantages

- Ability to share income with other parties e.g. spouse
- Flexibility to earn spasmodically and spread personal tax liabilities
- Financial control of your money
- Ability to maintain a separate pool of assets at low tax rates
- Clients are happy to use a company and hence leave all IR35 considerations to you

### Disadvantages

- No benefits if subject to new off-payroll working taxes
- Admin – you must be diligent to avoid penalties (DNS Accountants can help you with this)

## Umbrella Company

Simply stated using an umbrella company is a simple risk free alternative to setting up and managing your own limited company. The Umbrella company is managed by others and engages contractors by way of a contract of employment offering full employment rights.

### Advantages

- No admin
- Best choice if subject to Off-payroll working as opportunity for benefits e.g. pension contributions
- Better benefits packages than Agency workers

### Disadvantages

- All income subject to PAYE
- No control – dependent on Umbrella company
- Few tax planning opportunities

# Limited company route

A limited company is a type of business structure incorporated at Companies House as a legal person. It is separate from its members and can enter into any contract in its own name. It is responsible for its own actions, finances, and liabilities. It must be registered at Companies House as "Limited by shares" or "Limited by guarantee".

The money you earn as a contractor goes into the limited company and then you as Director choose when, how and to whom that money is paid out.

If you are caught by IR35 then there are big restrictions as 95% -100% of the contract monies have to come to you as your remuneration package. But if you have contracts that are not caught then you have many, many opportunities to save taxes e.g.

- By taking low wages and the rest as dividends
- By paying other family members, as shareholders or staff
- By leaving money in the company for other ventures or a rainy day
- By taking extensive staff benefits such as pension contributions or a company car

## Advantages of a Limited Company

- Easy to start up – it can be done online
- Separate legal entity – keeps activity and earnings from you personally
- Limited liability - restricts the amount of money you have a chance to lose, if everything goes wrong.
- Tax planning – opportunities for tax planning as subject to low corporation tax
- Professional status - has more professional appeal.
- Financial control - using the services of an umbrella company, you have to rely on the umbrella company for your earnings.

## Disadvantages of a Limited Company

- Costs -A company can be expensive to establish, maintain & wind up.
- Paperwork - More rigorous bookkeeping, you have to follow prescribed procedures rather than simply taking out cash from the company's bank account
- Privacy – Directors and accounts on public record
- Reporting - You have to maintain regular accounts which are more complex than those for a sole trader

## Umbrella company route

Simply stating using an umbrella company is a simple, risk-free alternative to setting up and managing your own limited company. The Umbrella company acts as an employer for contractors and freelancers who work on fixed term assignments.

The umbrella company engages contractors by way of a contract of employment, offering full employment rights. It then contracts out the services of the contractor to the agency or end client. The umbrella company will then collect the contractor's earnings from the agency or client and pay a salary to the contractor after deducting the umbrella company fee, tax and national insurance.

A freelancer or contractor will be able to enjoy most of the benefits of permanent employees instead of bearing the cost and difficulty of establishing a limited company. A contractor can easily work via an Umbrella Company. A contractor would neither be a company's director nor have the accountability related to managing a limited company. The umbrella company provider would manage all these matters along with tax management. A contractor's job would be to fill the time-sheet and regularly share it with the umbrella company he/she is working for – it is the responsibility of the umbrella company to raise an invoice to the end-clients.

The contractor always remains an employee of the umbrella company for the series of assignments they undertake. Hence there is no administration or paperwork required as everything is dealt by the umbrella company. This structure is suitable for contractors who are just starting out, expected to contract for a short duration like six months or earning less than £15/hour. This structure is also ideal for those who would be caught by IR35, especially under off payroll working rules.

### Expenses

In some cases, contractors operating through an umbrella company may be able claim tax relief on expenses they incur provided they are wholly, exclusively and necessary for fulfilling the duties of employment. The umbrella company will normally assess your eligibility to claim expenses and ask you to keep or submit receipts for each expense claimed.

Following new legislation by HMRC, post 6th April 2016 no compliant umbrella company will be able to process travel and subsistence expenses as tax free if you are subject to Supervision, Direction and Control (SDC).

There are lot of umbrella companies in the UK, that advertise themselves as compliant when they are not and lure contractors with advertisements like 'approved by HMRC', 'special dispensation with the Inland Revenue' and 'tax-free expenses'. HMRC can always challenge such umbrella companies and you can land up with a huge tax bill.

For the above reasons, it's important to work with a compliant umbrella company. Please contact us to know more about DNS Umbrella, the compliant way to get paid.

## What are the Benefits of Joining an Umbrella Company Scheme?

- It is very easy to use for a contractor – he/she just needs to fill in their timesheet and payment details and based on the invoice a contractor will be paid.
- All National Insurance contributions (NICs) and taxes are subtracted before a contractor gets the payment; hence he/she does not have to be bothered about further payment of taxes.
- Working via an Umbrella company is most appropriate for short-term agreements and agreements with a value of less than £25,000 per year.
- Helps a contractor to understand if contracting is good for them.
- All the paperwork will be performed by someone else.
- Usually better than client payroll option for those determined caught by IR35 under off payroll working rules.

## Disadvantages of Joining an Umbrella Company

- A contractor will receive the payment subject to pay-as-you-earn (PAYE) tax and National Insurance (NI) contribution whether the contractor is under the purview of IR35 or not.
- The contractor is dependent on the Umbrella Company to collect the money from the client and then make the payment to the contractor.

## How to select an Umbrella Company?

Before signing up with an Umbrella Company, it pays to do your own due diligence. Any reputable company should be able to provide you with appropriate documentation to back up their marketing and service claims.

For your peace of mind, here are seven core topics that you should address:

- Is the Umbrella Company UK based, HMRC compliant and properly audited? This will ensure that the company is not part of a tax avoidance scheme.
- Is the employment contract issued by the Umbrella Company HMRC compliant? Does it include the usual benefits – holiday and sick pay, maternity leave, pension provisions and minimum wage?
- Does the company operate an HMRC approved 'expenses dispensation' scheme?
- Do they offer relevant professional insurance cover (Professional Indemnity, Public Liability, and Employers' Liability)?
- How do they charge for the services they offer? Are their charges fixed or a percentage of your earnings? Are they weekly or monthly, gross (before tax) or net (after tax)? Do they charge entry or exit fees related to minimum term commitments? Be sure to establish this to be able to compare like for like.
- How frequently will you get paid? How long is the delay between time sheet submission and payment transfer to your account?
- Finally, what level of service and support does the Umbrella Company provide? After all, you are paying them so you should have easy access and full support for any questions or issues that may arise.

## What is better: Limited company or umbrella?

**Umbrella Company** - Under the umbrella solution you become an employee of the umbrella company and are paid through PAYE. You are required to submit timesheets and expense details on a weekly or monthly basis to the umbrella company. The umbrella company will then invoice the end client or the agency and pay you a salary after deducting income tax, national insurance and their margin for the services.

This solution is ideal for contractors and freelancers who are starting out or planning to work on shorter assignments. It involves less paperwork as the umbrella company takes care of the administration hassle as you are employed by them.

**Limited Company** - A limited company is your own personal service company that you can incorporate to run your business. To incorporate you need to register the company with Companies House, register for various taxes with HMRC, setup a business bank account and organise insurance cover. The limited company has statutory and financial obligations and is a separate legal entity from you. As a limited company director, you will be responsible for submitting all the relevant tax and business documents to HMRC and Companies House.

Limited company requires added commitment because of the statutory responsibilities and is suitable for contractors and freelancers who have a contract for more than 6 months and are earning at least £15 per hour.

Advantages	
Umbrella Company	Limited Company
It's the easiest solution as the umbrella company bears the administration hassle and pays you a salary.	This is the most efficient way of contracting. The take home is typically higher with a limited company as compared to an umbrella.
Insurance is provided by the umbrella.	Ability to claim wider range of expenses
Ideal for short term or temporary contractors.	You retain complete control over the business financials and there is no reliance on third parties to get paid.
The umbrella deducts all tax and NI before they pay you a salary. So, there will be no further Taxes to pay.	Greater opportunities for tax planning.
Quick and easy to setup, involves less paperwork and good for contractors who are just starting out.	This is more professional and helps you build a status as some clients prefer to work only with limited companies.

## Disadvantages

### Umbrella Company

### Limited Company

Dependency on the umbrella company is huge they are responsible for collecting the money you earn and then paying it to you. There is no control at your end.

There is less privacy as a lot of information is publicly available at Companies House like director details and accounts.

The most expensive way to operate as your entire income is subject to Tax and NI like a permanent employee and the umbrella company charges a margin on top for processing.

You, as a director, are responsible for everything, filing returns and accounts, submitting expenses and invoices; meaning higher administrative responsibilities.

Increased statutory rules and regulations the accountancy fee maybe higher and the penalties for not complying with the obligations can be high.

# Expenses you can claim

## What are allowable business expenses?

All businesses will incur some form of expenses. The amount and type will vary from business to business. Expenditure must be “wholly and exclusively” incurred for trading (business) purposes for it to be claimed back for tax calculations.

A sole trader or partnership may claim business expenses against income before paying tax

A limited company may pay for almost anything it wants to, but there are strict regulations on what is tax allowable and how to report and tax what is not. Hence it is usually best to stick to what HMRC will allow and what is standard practice.

Trading as a Limited Company, an individual may incur some costs personally; only if these have been incurred “wholly, exclusively and necessarily” for the business may they be reimbursed by the company. If expenses conform to HMRC rules of what may be claimed, then these reimbursed expenses may be tax and reporting free.

Directors and other business employees may receive various things from their employer by way of remuneration. All count as part of employee costs for tax purposes. Sole traders are not themselves employees.

If your employer is your own company, then you can choose what will form part of your remuneration. However, an agency or Umbrella Company may dictate or limit your choice

Here are the main categories of business expenses you may consider putting through your business: -

- Advertising and costs of marketing the business
- Bank charges including payment collection fees
- Books & magazines for reference or research
- Business rates & licenses
- Charity donations and sponsorship (not sole traders)
- Commission, royalties etc.
- Business assets (restricted to business use for sole traders)
- Computer equipment and software (restricted to business use for sole traders)
- Employer's national insurance contributions (NICs) payable on salaries paid to business employees
- Entertaining (not tax allowable)
- Goods for resale
- Hire purchase interest & fees
- Insurance, such as professional indemnity insurance
- Interest charged by lenders or on late payment
- Lease payments – office, equipment or vehicles etc.
- Mobile and Smartphone expenses (restricted to business use for sole traders)

- Office equipment and decoration (restricted to business use)
- Parts & materials used for sales
- Professional fees, such as accountant or solicitor
- Promotional gifts up to £50 per item
- Protective clothing & uniforms
- Rent for business premises
- Repairs and maintenance of business equipment or premises
- Salaries – including bonuses and sick pay etc.
- Subcontractor costs
- Staff benefits (for directors & employees only)
  - Annual health check
  - Christmas party (exemption for Directors and employees up to £150 per person per year)
  - Eye test when an individual is working on computer equipment
  - Health insurance
  - Mobile and Smartphone expenses (if the contract is in the company name)
  - Pension contributions
  - Professional subscriptions, if allowed by HMRC
  - Staff canteen costs
  - Trivial benefits up to £50 per item are permissible before more complex rules apply
- Stationery, postage, and printing costs
- Telephone and internet expenses
- Travel & subsistence expenses for business journeys (restricted for sole traders)
- Tools and consumables
- Training course fees as long as the skills are relevant to the business
- Utilities costs – for business premises – gas, electricity, water
- Vehicle running costs – for business vehicles only (restricted to business use for sole traders)
- Website development and maintenance

## Employee expenses

Additional expenses that can be claimed by employees

- Accommodation costs when away from usual place of business
- Home office costs (a flat £4/week without receipts is permitted by HMRC)
- The cost of business calls can be reclaimed on a residential phone bill
- Incidental overnight expenses of £5 per night (£10 per night if overseas) can be claimed if an employee is working away from home overnight on business
- The cost of subsistence while away from usual place of business – or HMRC benchmark rates
- Mileage allowances at HMRC rates

## Valid business expenses include:

### Travel expenses:

Employees can claim their work travelling expenses to a temporary workplace.

Car mileage can be claimed at 45p per mile for the initial 10,000 miles and post that 25p per mile in a given tax year, for travel in a private vehicle. The mileage allowance covers car servicing and taxes; petrol expenses; insurance charges; and other additional running costs associated with the vehicle. If travelling with a business passenger in the car, then he / she is entitled to claim an extra 5p per mile.

Motorbike mileage can be claimed at 24p for each 'business' mile and 20p per mile if he / she prefers to cycle to work.

Additionally, London congestion charges and car parking charges also form part of allowable travel expenses.

A temporary work place is one that passes the 24 month rule E.g.

Dema has worked for an employer for five years, during which she has always been based at their head office in London. In these 5 years, she was sent to Solihull to perform her duties at a secondary office for 18 months. Since, she was there for 18 months; Dema can claim travel expenses between her home and the Solihull office as a temporary workplace.

A sole trader contractor can only claim travel expenses for trips from any base of operations, not between home and any such base.

### Subsistence:

An employee travelling on business can claim subsistence costs e.g. a meal or coffee stop. The actual costs incurred or alternatively, the employee may claim the benchmark rate set by HMRC.

- UK Rates - £5 for 5 hours, £10 for 10 hours, £15 for 15 hours and £10 extra if after 8pm
- Overseas rates are per hour in the country and are set per city

A sole trader contractor can only claim subsistence expenses for trips that include an overnight stay or are outside normal working patterns.

### Accommodation:

Only actual costs incurred are allowed for UK accommodation, but the benchmark rates for overseas subsistence for employees include accommodation options per city. Meals can be claimed as above. Generally, there is no fixed limit/allowance for accommodation, but your claim for the same should be of reasonable amount.

### Secondary accommodation

A contractor can claim for accommodation if he or she is staying away from their permanent address during the course of a business assignment or business travel. This also implies that if a contractor is attending training related to work, he may be able to claim the expenses. An umbrella company will in general need a receipt that includes the secondary accommodation's name, address and telephone number (usually, an invoice will have all this basic information mentioned on it).

## Personal Incidental Expenses (PIEs)

HMRC have given an allowance for personal incidental expenses claims by employees staying away overnight on business. These expenses include the cost of a morning newspaper or a call made to the place of residence from a telephone. A contractor can claim up to £5 per night if he or she is working in the UK and up to £10 per night outside the UK.

## Training

Work related training provided by an employer to its employees is allowable. Training costs are not however allowable if paid for by the individual employee. Related costs such as travel to the course, course materials and exam fees are also allowable, as are integrated costs such as meals and event activities. However, expenses in the nature of reward, inducement, recreation or entertainment are specifically not allowable.

## Cost incurred while under training

Unless a contractor is able to justify the training expenses are linked to their existing contract, there is only a very remote chance that such expenses can be claimed.

## Medical needs – Eye examination

The employee can pay for an eye test for each employee required to work in front of laptop/monitor or any kind of display screen for at least an hour daily.

## Clothing

Cost of your everyday wear is not a part of a valid business expense. However, uniform or protective clothing can be classed under valid business expenses. Uniform is defined as a set of clothing of a specialised nature that is recognisable as a uniform and is intended to identify its wearer as having a particular occupation. Protective clothing is defined as that worn as a matter of physical necessity because of the nature of the job.

## Home-office costs

If you spend business time at your home office, you can claim a percentage of the additional costs of using your home for business e.g. electricity bill, broadband charges, telephone bill, metered costs of gas and water. However, if you are using your home-office only for paperwork and accounting, you may prefer to claim the £4 per week allowance rather than doing the calculations.

## Pension contribution

If you wish to top up your pension then it is very tax efficient to do this via your employer, either as salary sacrifice (e.g. employees) or just extra remuneration (e.g. directors). Remember there are caps to investment in pensions so do talk to a financial advisor about this.

A contractor can invest in pension schemes to save taxes of up to 54%. Pension payments are paid direct by the umbrella company to enable a contractor to build on their pension savings thereby reducing the amount payable as taxes.

## Computer equipment and software

Costs/expenses incurred in purchase or maintenance of computer equipment, hardware and software can be classed as a valid business expense, as long as it has business use.

A contractor may be able to claim for equipment expenses if he or she can prove that the equipment is imperative for effective work and form an essential part of their current assignment.

## Professional memberships

During the course of work, a contractor may require certain subscriptions to work more effectively. The business can claim the cost of any trade or business club membership. However, HMRC have a list of the only allowable personal professional membership subscriptions that are tax allowable.

## Health insurance

Medical and Health insurance can be classed as a valid business expense, however most such policies are then taxable on the individual employee as taxable benefits. A Permanent Health Insurance (PIH) Policy may be tax allowable but needs to be in the name of your company.

## Annual staff event

An annual event for staff (directors & employees), is a tax allowable business expense; and will not be taxable on those staff members provided these conditions are met:

- It happens every year i.e. is annual
- It is an event i.e. booked not ad hoc
- All staff (at that site) are invited (can include subcontractors)
- Annual cost per head of all such events does not exceed £150, including VAT.

## Billable and Non-billable expenses

A billable expense is defined as reimbursement for a cost incurred by a contractor that is then paid to the umbrella company by the end client as an addition to the normal labour invoice. The nature of the expense will determine whether it can be paid back to the contractor before tax from the umbrella company. On the other hand, a non-billable expense is incurred by a contractor and is not charged on to the end client as an addition to the normal labour invoice.

## Pre-trading expenses

There are certain expenses which are incurred prior to the setting up of a company like meeting clients, phone bills or equipment costs. If these expenses are incurred in anticipation and made within 7 years of your first day of business, you can claim them as business expenses.

Working as a director or an employee of your company gives you an added advantage of claiming valid business expenses through it, which you may not be able to do through an umbrella company.

# Expense claims & 24 month rule

Many contractors may have heard of the 2 year or 24 month rule with respect to travel and subsistence expense claims. In this section, we have tried to provide a simple explanation of the rules, and how they apply to contractors and freelancers. Contractors are allowed to claim travel and subsistence expenses as long as such claims relate to a location which meets HMRC's definition of a "temporary workplace"; being a workplace which is not a "permanent workplace" as you are not allowed to claim such travel expenses.

## What is a Temporary Workplace?

A temporary workplace is one a worker attends to perform his duties for a limited duration or for a temporary purpose. In this instance a limited period is seen to be 24 months or less. For example when a contractor travels to a client site for work this may be considered a temporary workplace and hence all travel and subsistence expenses related to this temporary workplace will be allowed. Or you can say that a Temporary work place is a place where a worker attends, or expects to attend, that location for a period of less than 24 months. Remember that ordinary commuting is not allowable. Ordinary commuting is commuting to a permanent workplace and for most contractors their permanent workplace is their home which they use as their office.

Where a worker can reasonably expect to be at the same workplace for 24 months, or becomes aware that they might be, it is seen to be a permanent workplace. This applies where a worker is employed on a permanent basis or as a temporary worker on a project which has an actual or expected duration of more than two years. As such, a workers intention and expectation can be viewed as being as important as the actual time involved.

## What is a Permanent Workplace?

In order to get the concept of temporary workplace fully clear it's important to understand the concept of permanent workplace. It is not uncommon for a worker to return to the same place of work after a period of absence. Where the worker has spent more than 40 per cent of their working time at that workplace in a 24 month period, even with a break in engagements, the workplace is still considered permanent.

## The 24 Month Rule

If you work at the same location beyond the 24 month mark, you may no longer claim travel expenses. And crucially, the moment you are aware that your contract will last beyond the 24 month mark, you must stop claiming travel expenses. This means that if you are aware from the outset of a new contract that the project is likely to last beyond 24 months, you must not claim any travel expenses between your home and place of work - from day one.

This may be from day one - if you are engaged on a project and you know from day one that your involvement will last three years, then you get nothing.

If you are engaged on a project and your involvement will last 18 months then you are fine unless, say, after ten months you find that the job is so far behind schedule it is going to take 25 months. As from that date you cannot claim.

If you are engaged on a project and your involvement will last 25 months then you cannot claim. If after ten months the project is two months ahead of schedule then the finishing date is 23 months from the commencement. You can then claim as from the ten months (but not for the first ten months as the likelihood at the time was that it would exceed the 24 months).

Or, in the words of HMRC: - This rule says that a place cannot be a temporary workplace if the employee's attendance is:

- In the course of a period of continuing work at that place lasting more than 24 months, or
- If it is at a time when it is reasonable to assume that it will be in the course of such a period.

## Business structure

The 24 month rule applies regardless of the business structure you work under (limited company or Umbrella Company being the most widely used). Changing your agency, Umbrella Company, or even employer makes absolutely no difference to the application of these rules.



# Decision time

## Introduction

Having chosen to go contracting, you need to choose the entity that is best for you. This guide has given you details of the options and hopefully you will have an idea. But if you are still stuck then do talk to DNS Accountants to help you decide or visit <https://www.dnsassociates.co.uk/help-me-choose>

## IR35

We recommend that you should have an IR35 review before starting your contract or project. After that you should update the review of your working practices every 6 months. Moreover, you should get every new contract reviewed. This will ensure you are compliant with IR35 legislation. DNS have a competitive review service – to see terms and book a consultation visit <https://www.dnsassociates.co.uk/ir35-review-service-terms-conditions>

## Sole trader or partnership

Do ask for our helpful guides.

## Limited company

Do ask for our helpful guide. Or visit <https://www.dnsassociates.co.uk/easy-guide-for-setting-up-a-limited-company> for set up details.

## Umbrella company

If choosing an umbrella company then you need to compare what is on the market. Do visit our helpful guide at <https://www.dnsassociates.co.uk/blog/how-to-compare-umbrella-companies-for-contractors>

DNS operate an Umbrella Company that we believe offers you all you could want, while being HMRC compliant.

## Other services

DNS Accountants are always here to help. Please ask us about

- PI insurance
- Business insurance
- Tax planning
- Self-Assessment Tax returns

# About dns

DNS Accountants is a highly respected, award winning accounting, tax planning and consulting services practice with a national presence across the UK. We have specialist expertise in helping contractors, freelancers, owner managed businesses, and construction industry clients.

Since we started in 2005 we have achieved substantial growth, with us now servicing thousands of clients across the UK, many of them contractors. As a CIMA (Chartered Management Accountant) Member in Practice our team of highly qualified accountancy professionals are readily available to provide accounting and tax support to our many clients. In addition, we are an FCSA Accredited Member, having been independently audited to ensure we adhere to the rigorous FCSA Codes of Compliance for our contractor clients. We are also a Professional Passport Approved provider having met their rigorous compliance standards.

## Services

Our accountants take full responsibility of all your accounting solutions so that you can easily focus on your core business activities. Our accounting experts have more than 10 years of experience and are experts in resolving all bookkeeping & taxation matters. We are serving many clients on a daily basis and providing them with the best services 24/7. Our services include payroll, filing income tax returns, VAT returns, landlord property tax returns, R&D tax credits, IR35 review etc. Our other services include bank accounts, business insurance, IPSE membership, tax investigation cover, business plans etc. In addition to these services, we also offer cloud accounting software, named "Nomisma", a complete solution for all your accounting needs.

## Guarantee of service

We ensure that we provide you a good quality service at an affordable price and guarantee expertise, excellence, responsiveness & confidentiality in our services.

## Awards & Accreditations



FINALIST





## Award winning accountants



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