

Contractors need to save for corporation taxes and vat

If you have a profitable year as a contractor, you will need to keep watch on the [corporation tax](#) you owe, along with your [VAT](#).

Study Shows We Don't Keep Up

This may seem obvious, but most of us don't, according to a study by [Alliance & Leicester Commercial Bank](#). According to the study, of the 3.4 million small businesses in the UK, the vast majority have to struggle at the end of the year to come up with payment.

Only 40% of SMEs have set aside sufficient funds to cover their corporation tax payments ahead of the deadline for their business, according to the study. And despite saving to pay their bill, more than four in ten of these companies (44%) keep the money in a current account, missing out on millions of pounds in potential interest by not making their money work harder for them.

Worse, about 19% don't save money for these payments at all. But with penalties and interest charges for companies that miss their payment date, this can be an expensive mistake to make.

You Can Collect Interest

You should know that saving for taxes and VAT can pay off. You pay VAT every quarter, so you can collect interest on the funds until the payment date. If you pay electronically--which is the simplest and safest way to handle the tax--you can even wait another month after you file your return to pay the bill. As for tax, you can put it in any kind of high-interest account you want, knowing that you won't have to pay it until the end of the year.

Bankers point out that this is the wisest course. "The corporate tax bill can create sudden cash demands on a company, particularly on SMEs who might already struggle with their cash flow. These companies should not jeopardise their future business prosperity by dipping into company profits or using their own money," explains Steve Jennings, Director of Business Banking at Alliance & Leicester Commercial Bank.

How To Calculate Your Tax

The majority of contractors earn under 300 thousand pounds per year, and so they pay corporate tax at the rate of 20% (If anyone is earning more, please tell us how you do it? The rest of us would like to know!)

So how much do you need to save? You probably take a salary, which is taxed at the source, and you pay your National Insurance contribution on it. After that you deduct all expenses related to running your limited company, including accounting fees, any equipment you buy, any travel expenses, etc. Don't forget bank fees--they add up.

The basic formula to use is: 20% of your profits. Profits = Revenue - Expenditure (expenses + salaries + employers NI + pension contributions).

Jennings suggests you skim off this amount--that is, take 20% of estimated profit (be generous!) and put it in a money market account, a fund, a special corporate savings account, or in any reasonably risk free investment. Don't play the market with this money, but do try and find something with a better rate than an ordinary checking account or savings account. "There are a number of deposit accounts which pay very poor levels of interest and I would urge business owners to shop around and make their tax savings funds work as hard as they can," Jennings says.

What About VAT?

You pay VAT every quarter, and you know how much you are to collect because you know what your fees are. When you receive payment, take the VAT funds and deposit them in a money market account, for example, which bears a higher interest rate but which permits you access when you need it. There are also some short-term fixed interest deposits that pay a bit better than what most banks offer on savings. Shop around.

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“ I stick all my excess cash in a term deposit account which rolls over every 3 months. ”

Pete - London Contractor

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“ The corporate tax bill can place a sudden cash demand on a small company ”

Steve Jennings-Alliance & Leicester

“ Make your tax savings funds work as hard as they can ”

Steve Jennings-Alliance & Leicester

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Contractors, are you saving for your taxes?

You pay the tax bill at the end of the year, but most of us don't plan carefully to pay it. And are you making good use of the money you hold for taxes and VAT?



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