

Spending contractor limited company profits tax efficiently

Contractors looking to distribute the profits in their [contractor limited companies](#) in the most tax efficient manner would be wise to check their house is in order first, says Duncan Strike, managing director of contractor accountants [Quay Accounting](#).

He comments: "Before taking the decision to pay [dividends](#), declare bonuses or make significant investments with company money, contractors should first confirm that they have any tax liabilities covered"

Strike recommends that contractors next ensure they have sufficient financial reserves in the event that they cannot find work. "They might feel secure now, but things can change very quickly, typically due to market conditions or an illness," says Strike. "And even if the contractor has [permanent health insurance](#), the level of cover may not be sufficient if they have not kept levels of cover up to date."

Tax under-provision is common

"It's very common to find contractors who have taken the minimum amount to meet day to day living costs out of their contractor limited company but who find they have personal tax liabilities yet to be paid," continues Strike. "Only regular tax planning with an accountant can ensure the right provision has been made."

Strike says that another potential problem, for which contractors should put aside money, is [IR35](#). As he says, "We all know that contractors' past financial and tax affairs can be investigated by HMRC, so if a contractor is found to be within IR35 for one of their previous contracts, the fallout can be [very costly](#)."

"Ensuring that all new [contracts are reviewed](#) should be a given, and contractors should work with professional advisers to retrospectively review past contracts, too," says Strike. "If there is any risk that HMRC might investigate, as they may do following a ruling on a tax case, then contractors should allow for appropriate provisions now."

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And the fun starts here...

Despite suggesting that contractors put aside appropriate sums for tax, and unexpected periods without a contract, Strike says there can still be plenty of cash left for contractors to spend, and that's where things can get interesting and whole lot more fun. After all, the extra money and what it can buy is a key reason many contractors choose the lifestyle.

"One of the first decisions a contractor must make is whether they want their investments to be in the company's name, or in their personal name," explains Strike. "Taking cash out of the company and spending it on investments personally may create an additional personal tax liability and thus reducing the amount available for investment. Equally, investments made in the company may result in double taxation on the eventual gains and profits when you come to take out the money personally." This is another conversation contractors should be having with their accountant.

And before taking any major decisions, a contractor should appoint an Independent Financial Advisor (IFA) who is experienced in managing contractor affairs and has a strong track record with, and client base of, contractors.

Contractors should expect their first conversation with a newly appointed IFA to revolve around their attitude to risk, which will ultimately dictate the kind of investments recommended and the returns the contractor can expect to receive.

"Contractors tend to be risk averse when it come to investing their cash," says Strike, "so don't be persuaded to invest inappropriately, but don't be scared away from assets that currently have depressed values if your investment time span is longer term, and the projected outcome of the asset is recovery."

Contractors beware

But, admits Strike, there are times in the economic cycle where property rents are low, property values are falling and interest on cash savings are poor, so contractors may have limited options.

So where do contractors turn to get a decent return? Strike says: "Many contractors choose to invest their money in business opportunities, much like business angels. However, despite being successful contractors, they frequently do not have the right skills and lose their money.

"The old maxim is still very relevant: 'If it looks too good to be true, it probably is.' Contractors should think again and put their cheque

books away!”

Safe(r) bets for contractor cash

[Pensions](#) are not always the safe bet, although investing whilst share values are depressed is worth looking at, and pensions not only reduce corporation tax liabilities, but have the added advantage of providing contractors with greater options as they approach the age of 55.

“Some contractors with the right attitude to risk may want to consider creating a mini-group,” explains Strike. “This might be made up of two companies operating as a contractor limited company on one side, and on the other as Investment Company that might own properties, alternative businesses or other investment assets. Each company is protected against the liabilities of the other and contractors should be mindful of the ‘associated company’ rules.”

According to Strike, contractors should follow a simple process to optimise the use of the cash in their contractor limited company: “Contractors should first determine what the excess cash in the business is, then decide what will give them their required return in the prevailing economic climate and whether the investment is personal or corporate. Then they need to find independent financial advisers who are in the best position to help them optimise their investment.”

Strike concludes: “Even with low interest rates and an unstable investment outlook, it’s still possible to make reasonable returns on the cash in your contractor limited company and especially when the fiscal year -end fast approaches, it is the time for contractors to make the right enquiries with their advisors.”

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