

Contractors rarely operate as sole traders

Despite the fact that starting a new business by becoming a sole trader is the easiest and fastest way to get trading, this simply isn't a workable solution for contractors. They have to choose other trading solutions, with the most likely options being to [set up a limited company](#) or to join a [contractor umbrella company](#).

So, why can't contractors be sole traders? Well, clients and agencies won't do business with sole traders for many reasons. These include the fear clients have that a sole trader contractor might be seen in law as an employee with all the employment rights that go with that; whilst for agencies, they are wary of debt transfer and employment agency legislation that requires workers to be paid under PAYE schemes.

In addition to all of this, contracting as a sole trader, even if it could be done, would have downsides for contractors themselves. For example, sole traders face virtually unlimited liability, which means that as sole traders their homes and other personal assets would be at risk of litigious clients.

Agencies and sole trader contractors

Recruitment agencies and employment businesses in the UK are subject to huge amounts of regulation. The law requires that 'self-employment', ie being a sole trader, is not permitted for agency workers, and income tax and National Insurance Contributions (NICs) must be deducted at source.

Plus, under the debt transfer provisions of the [Managed Services Legislation](#), an agency could be liable for the unpaid tax liabilities of contractors who have ceased trading, 'done a runner' and owe money to HMRC.

Contractors who have reasons why they do not want to start a limited company – they could be a disqualified director for example – could still find contracts via an agency by joining an umbrella company or going on the agency's payroll, but neither of these options are as tax efficient.

Clients and sole trader 'employees'

It has been known, under some circumstances, for contractors to work direct for a client as a sole trader. However, this is incredibly unusual and the vast majority of clients simply won't work with sole traders, for a number of reasons.

Firstly, there is the risk that a worker trading as a sole trader could claim employment rights from the client. This is quite common in sectors such as construction, and is the feature of numerous Employment Tribunals.

A contractor sole trader is one step closer to the client as they have no legal entity, such as a limited company or umbrella company, separating the individual worker from the client employer.

So, clients taking on contractors direct, especially if they are dealing with a new contractor, will tell them that, if they want to work, they must incorporate, ie form a limited company.

Preferred or exclusive agency arrangements

Clients, particularly large organisations in the private and public sectors, frequently have agreements by which they engage the services of a preferred recruitment agency, or have an exclusive arrangement. The preferred agency is typically also a larger business.

A sole trader contractor might attempt to win a contract with the client, but the client's agreement with the agency means that the contractor has to work through the preferred or exclusive agency if they are to work at all.

In this scenario, the agency will almost certainly insist the contractor incorporates if they want the contract, or the contractor will have to go on the books of the agency under a PAYE scheme.

Sole trader risk for contractors

Contractors who trade as sole traders are lumping their business assets and personal assets together. The law and HMRC do not distinguish them in the same way that a limited company is a separate legal entity from the contractor director and shareholder behind it.

This potentially places a contractor's personal assets, including their home, at considerable risk, particularly in litigious sectors where a contractor may be sued by a client.

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By using a contractor limited company, an umbrella company, or even an offshore option, the contractor's home and personal assets are much safer than if they worked as a sole trader.

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