

## Contractors should understand margins and tax

Contractors need to understand how contractor fees break down in payment and tax terms.

You need to understand:

- o Gross versus net fees
- o [Limited companies](#) or [umbrella companies](#) or agency vehicles
- o Agent margins
- o Taxes: PAYE and National Insurance contributions (N.I.)
- o Value Added Tax (VAT)
- o Employee vs. employer contributions

### When You Sign With An Agency

Let's suppose you've just [signed a contract with an agency](#). Agencies [don't like to deal with self-employed contractors](#), so you probably are either with an [umbrella company](#) that handles your administration, or you have your own [limited company](#). There is the rarer third possibility that the agency itself wants to employ you for the duration of the contract.

If you've signed up as a limited company, the agency should quote you a figure gross of all deductions and that's what you get paid. You should see that the contract you've signed clearly states what fee you are to receive. There are no deductions from this fee, although as we'll see later, the agent takes a margin on what the client is paying.

Do not sign any contract unless it clearly states the fee that you have agreed upon, and clearly states that there are no further deductions to be taken from it. Do not, under any circumstances, sign a contract which does not clearly state what you are to be paid. Never mind what the agent or anyone else says. JUST SAY NO!

We get complaint after complaint from contractors that they've signed a contract which doesn't have the amount they were promised in it. Once you sign, there is nothing you can do about it. So don't sign. That applies to [contract renewals](#) as well!

### Limited Company Or Umbrella?

With a limited company structure, it is your own responsibility to determine how you pay tax on that income. You have the possibility of taking all of it or part of it as salary - in which case you will have to deduct PAYE tax and National Insurance contribution from it, or you can take it as a [dividend](#) (if outside [IR35](#)) in which case you only pay a percentage as tax. For now, although we are threatened with change in this area, dividends are still the best route. (For the threat see our special section on the upcoming [income shifting legislation](#)).

If you work with an umbrella company, the situation is slightly different. The umbrella company will handle the tax and National Insurance contribution for you. There are three elements here: PAYE tax, National Insurance Contribution, and the Employer's National Insurance Contribution. In the UK, the NI is split between the employer and the employee. Obviously, the umbrella doesn't pay the Employer Contribution for you; it takes it out of your fee as part of its overall fee structure.

"Every contractor should understand that these three components: PAYE, Employer's National Insurance Contribution, and Employee's National Insurance Contribution, have to be dealt with by whatever vehicle they choose," says David Marples, a lawyer with the legal consultancy [Abbey Tax Protection](#) in Rugby. "If you work with an umbrella, or an agency, your contract should clearly state how these three components are to be handled. You should never pay them twice!"

Exactly the same is true should you work for an agency directly. The agency will take the various deductions out of your fee. But what must never happen is for the umbrella or agency to agree to a net fee, and then to claim there are further deductions from it.

The rule is the same: get your fee clearly stated in the contract, and see that the phrase "net of all deductions" follow it. Always see that the amount to go into your bank account is stated in the contract. Any deductions from your gross fee should be transparently stated as well, but nothing matters so much as having the fee net of all deductions clearly stated in your contract. Write it in yourself if you have to.

### Value Added Tax

Contract rates are always quoted excluding VAT. If you are using a limited company and are [VAT](#) registered you will then charge VAT

**“ Never sign a contract which does not state your fee net of all deductions. Just say no. ”**  
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on top of the gross fees. This VAT is then paid to HMRC in your quarterly VAT return (minus any VAT you've spent on company purchases). If you work via an umbrella, which will certainly be VAT registered, they will do the same.

## Margins

Agencies, obviously, have to make money somehow, and what they do is to take a percentage of your total fee from the client as a margin. That's fine; that's how it works.

## Get Your Rate For The Job

But the agent's margin is in no way your problem. You will hear endless griping from agents about how their margin has to be this, or that, or that the agent has to take a certain percent once you've been offered the contract.

Once and for all: the agent's margin is the agent's problem, not yours. Your fee is agreed upon from the start with the agent having already deducted a margin. You make sure your fee is what you expect. After that, give the agent nothing. You get the fee you've agreed upon stated as "net of all deductions" in the contract, and let the agent worry about the margin. Pay no attention at all. Get the rate you want for the job, and the client and agent work out the rest between themselves.

**“ Whether you work with an umbrella or an agency you should know exactly how tax and National Insurance deductions are handled and you should never pay them twice ”**

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