

Contracting via a limited company: Preparing to trade

Contracting via a [limited company](#) is straightforward, but, says Clare Rickman of contractor accountants [Intouch](#), "Incorporating a new limited company is only the first step in becoming a limited company contractor.

"Before a contractor can start work on their first contract and begin trading, the new company should: [open a business bank account](#); be registered with HMRC; be ready to [issue invoices](#) in the correct format; and have systems in place to [pay salaries](#) and [dividends](#)," she says.

Contractors must also set up systems to invoice clients and agencies, and decide how best to remunerate themselves with a combination of salary and dividend. This may also require running a payroll.

Opening a business bank account

"A limited company is a legal entity in its own right and, in order to trade, must open a company bank account," explains Rickman. "Post-credit crunch, it's a lot tougher to open a business bank account, so contractors with a poor credit history or county court judgements (CCJs) might need to shop around.

"Contractors having trouble opening an account because of a poor financial history may find their contractor accountant can introduce them to a sympathetic banker, as some of the smaller and specialist banks recognise that even contractors with low credit scores can be good business banking customers," adds Rickman.

When a contractor is applying for and opening a business bank account, the bank will usually require a great deal of information about the contractor and fellow directors. And, despite claims in banks' marketing literature, it's rarely a speedy process as the bank will undertake in-depth credit checks on the directors. Further delays are added as banks must legally undertake further checks as part of the UK's anti-money-laundering laws.

Registration with HMRC

Another essential step is to register the company with HMRC, which can be done as soon as the company is first incorporated. Failure to register could result in fines, which is not a great way to launch a new business! However, Rickman says a contractor's accountant should handle the HMRC paperwork, although contractors should be prepared to sign a lot of forms.

"Contractors need to register their company with HMRC for corporation tax, [VAT](#) and Pay As You Earn (PAYE)," she says. "A good accountant will also ensure that their contractor clients stay on top of HMRC paperwork, as failure to do so could result in penalties for late filing."

Contractors need to file a number of forms during the company tax year, such as P35s, P11Ds, corporation tax returns, quarterly or annual VAT returns, and other documents at financial year-end. They will also need to file a personal tax return, which their accountant will prepare.

Some of this 'paperwork' is done online and so will involve online registration. Contractors will need to decide whether to deal with HMRC online themselves, or if they prefer to grant their accountant rights to do so for them. Doing so can help ensure crucial deadlines are met for payments and submissions of forms.

Trading – sending invoices and collecting money

A contractor's limited company starts trading as soon as the contractor begins work on their first contract and is owed contracting fees. Preparing timesheets and invoices correctly, collecting payments and [managing late payers](#) are all key contracting skills.

Rickman explains: "From the outset, contractors should ensure that their invoices are correctly prepared, so that they don't give their client's accounts staff an excuse not to pay on time. Late payments could be a sign of a more serious problem with a client or agency, so contractors should never let debts from clients build up."

And at the same time as managing their income, contractors should keep a close eye on business costs, by ensuring that they carefully record all their [expenses](#). This is particularly important in the first few months, as there are likely to be many start-up costs, such as computer and office equipment, plus marketing, which need to be properly charged to the company.

Starting to pay salaries, dividends and expenses

Once they are trading, contractors will also need to work out how much they should budget for corporation and personal tax each month. Rickman recommends they leave at least 20% of the value of their first couple of invoices in their business bank account until their accountant has evaluated their tax status.

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Clare Rickman, InTouch

"The tax affairs of new contractors can take a short while to settle, as it is likely that they were employed for part of the financial year in which they have started trading," she says. "They should therefore provide their accountant with any relevant paperwork from their former employer that details how much tax they have already paid that year."

Once a contractor's tax affairs have been smoothed out, it is likely that they will wish to maximise their income by taking a combination of salary and dividends. So an important step is deciding what level of dividend to declare and how frequently to declare it. They must also ensure that the correct paperwork is in place, or in a subsequent investigation HMRC might declare a contractor's dividends to be illegal, to be a [directors' loan](#), or to redefine it as salary, before taxing it accordingly.

"After trading for a few months, contractors usually settle into a pattern of low salary and regular, often monthly, dividends, which their accountant will help them to calculate," says Rickman. "From that point, it is important for contractors to update their accountant of any changes of circumstances, particularly if they think their current or future contract may be inside [IR35](#), because this will impact on how they manage their finances."

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