

How does taxation work in the UK and why is this important to expat contractors?

Expatriate (expat) contractors [contracting in the UK](#) will rapidly learn that, as a contractor, they are under particular scrutiny by UK tax authorities. Therefore, they must learn as quickly as possible how to effectively manage their UK tax affairs.

Ideally, they should gain this knowledge before they ever enter the UK, and certainly before [negotiating their first contract](#). Not to do so can prove to be a very expensive mistake.

When they start contracting in the UK, expat contractors will almost certainly be working for their own [contracting limited company](#) or for a [contractor umbrella company](#), although some may consider offshore solutions.

Whichever solution is chosen, new expat contractors should ensure they take advice from their accountant, umbrella company customer services team or offshore solution provider to stay within UK tax legislation. Ideally, they should also engage the services of a professional who can check contracts, before they are [signed](#), for any tax implications.

The UK tax authorities

The government organisation responsible for collecting taxes in the UK is [Her Majesty's Revenue and Customs](#), or HMRC for short. HMRC is also often called 'the revenue', 'inland revenue' or simply 'the taxman', and these names are frequently used by both contractors and contractor advisers.

HMRC is an agency of the UK government department called Her Majesty's Treasury, which, as its name suggests, is responsible for controlling government spending and raising government revenues.

Expat contractors can find out more information about [HM Treasury](#) and HMRC from the [Directgov website](#). This also shows how the UK government is structured and which department, ministry and agency is responsible for each areas.

How tax is collected

Employees in the UK are 'taxed at source' via a system known as 'Pay as You Earn' or PAYE. This means their employer automatically deducts income tax and other indirect taxes, known as National Insurance Contributions (NICs), when the employee is paid, and the employer pays the tax revenues directly to HMRC.

But contractors who work through their own contracting limited company don't pay tax like this, because they are not employees. Such contractors pay tax based on an annual tax return, which calculates their tax liability after deductions, expenses and a variety of other rules. Understanding these rules is central to understanding how contractors can legally pay less tax.

Employees who are taxed at source can pay significantly more than contractors who work through a contracting limited company. And there is no reason why a non-UK or non-EU national can't work through a limited company and enjoy the financial benefits from day one of their first contract.

ContractorCalculator has a [range of calculators](#) that will help you explore how much more contractors can earn than their employee counterparts.

Tax efficiency is not illegal

Where a citizen or organisation such as a limited company or partnership deliberately misleads HMRC to avoid paying tax, this is tax evasion and illegal. As such, it attracts severe financial penalties and can lead to imprisonment.

However, it is possible and entirely legal to reduce the amount of tax that needs to be paid by being 'tax efficient' – in other words, understanding the tax system and ensuring you benefit from the rules, rather than falling foul of them.

Seeking professional advice from an accountant or tax adviser that specialises in contractor affairs can help considerably reduce the amount of tax the contractor needs to pay. In fact, seeking experts' help is highly recommended because, at the very least, they are likely to pay for themselves by ensuring you don't pay more tax than you should.

Because of the way that most contractors work, through their own contracting limited company, contractor umbrella company or offshore solution, contractors can legally pay much less tax than employees. But only if they stick to the rules.

Why contractors are high profile targets

It is because contractors have the potential to pay much less tax than employees that they have become a target of the government's revenue-generating bodies, such as HM Treasury and HMRC.

These bodies have sought to increase the amount of tax that contractors pay, and recent years have seen a regular stream of new tax legislation that has badly affected contractors who have not understood its implications.

But to many highly skilled knowledge workers in the UK, the very fact that government and HMRC target contractors is an incentive for these workers to become contractors – after all, HMRC would not be after contractors unless they earned so much it was worth HMRC's while to do it!

IR35 – the contractor's tax

Probably the most important tax legislation affecting contractors is [IR35](#). If a contractor is affected by it (which is known as being 'caught by' or 'within' IR35), they could suffer a [drastic loss of earnings](#) and/or be forced to pay HMRC substantial back-taxes and penalties.

Before coming to the UK, and certainly before [signing their first contract](#), it is essential that contractors understand how IR35 might affect them, their contracting career and their earnings.

A dedicated area of this website covers everything a contractor needs to know about [IR35 tax legislation](#). And the [Contractors' Handbook](#) has easy-to-follow guidance that is likely to help contractors avoid falling into any [IR35 traps](#).

But not only should expat contractors [learn the basics of IR35 themselves](#), before they ever sign a contract they should also consider having a professional undertake an [IR35 contract review](#).

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