

Processing your company payroll when contracting via a limited company

For contractors who run their own **limited companies**, maintaining their payroll and associated records may seem tedious; but it is, in fact, an important statutory requirement and, as Phil Richards of accountant **Blevins Franks** points out, failure to do so could bring down the wrath of HMRC.

"When a contractor first starts trading with their limited company as an employee, they are required to register as an employer with HMRC," explains Richards. "The company then has to operate the Pay As You Earn (PAYE) scheme and deduct income tax and National Insurance Contributions (NICs)."

As a director of the company, it is also the contractor's statutory role to maintain accurate records and their responsibility to ensure that tax and NICs are paid at the right time.

Of course this doesn't apply to contractors who work through an **umbrella company**; they should only need to ensure they submit their signed timesheets promptly and their umbrella company should handle the rest of the process for them – it's one of the key services covered by umbrella companies' fees.

What does the contractor have to do?

"Setting up a pay-roll is not challenging and **registration with HMRC can be completed online**, with the information they require being very basic," continues Richards. "Then the contractor should agree with their accountant **what salary they will pay themselves as director** and at what frequency, usually monthly."

In fact, HMRC actually offer a tax-free incentive payment to qualifying small employers, such as contractors, who file their information online.

Richards stresses that contractors are also required to maintain records: "Payroll records must be kept for up to seven years, even if they are the contractor's personal payroll records. In addition the contractor must retain whatever records they are using to calculate payroll."

But this need not be onerous because if, for example, the contractor was using one of the many online services available to calculate and manage payroll, they would not need to keep records as everything is online.

Once the gross salary has been agreed with their accountant, income tax should be calculated from the gross amount according to the latest allowances. NICs should then be calculated on the gross salary; these will be class 1 or possibly class 1 A contributions, as the contractor is an employee of their own limited company.

Contractors' expenses

Contractors can choose to process their **legitimate business expenses** separately using their own expenses forms (for **IR35** status reasons they should never use a client's or agent's expenses forms) and pay themselves from their business account into their personal account (see **processing expenses**).

Alternatively, contractors could choose to include their expenses with their payroll payment. If contractors provide themselves with a 'perk', or claim for an expense that has a private usage component, then they may have to check with an accountant or payroll provider, because there may be additional income tax or NIC liabilities.

Payroll software for contractors

According to Richards: "There are so many inexpensive yet highly effective software and online tools available contractors could, if they chose, manage the entire process themselves without using an external payroll supplier."

Online systems can run the entire process, doing the calculations based on gross salary, producing payslips, calculating income tax and NIC payments required for HMRC, managing payments and even creating the various forms required throughout the year, such as a P46 or P11D.

Contractors must still ensure that their income tax and NICs are calculated correctly and paid on time. It is also possible to use an outsource payroll company or an accountant to complete the calculations and then instruct the contractor what to pay and when.

Contractors' responsibilities

Richards recommends that contractors take at least some responsibility in managing their own payroll: "Ultimately, even if the payroll process is outsourced, it is the contractor who is a director of their company who would be liable if there were any errors in calculations or late or missed payments.

"So," Richards concludes, "as it is such an important part of running a business, contractors should actively manage their own limited company's payroll, even if they are the only employee."

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Phil Richards, Blevins Franks