

A Quick Start-Up Guide from PayStream

So you're thinking of becoming a contractor? Perhaps you are looking for the flexibility that comes with working in this way, or perhaps you are working in an industry where all the best jobs seem to go to contractors.

Whatever your reasons for choosing this kind of work starting out as a contractor means that you need reliable information. We have answered some of the most common questions for you.

How do I become a contractor?

The first – and probably the scariest – step is to give notice at your current job. Then you can begin looking for contract work. It is possible to look for contract work while still in your job, but most agencies and clients want people who are available to actually start work as soon as possible. A minority of contracts are advertised several weeks in advance, but your options are very limited if you are on four weeks' notice.

Getting your first contract is the next step. You may already have contacts in your industry who can give you leads to follow up, but most contractors use agencies to find work, particularly when they are starting out.

Then you need to decide how you will operate as a contractor. There are three main options, which this guide will discuss more fully later.

- [Limited company or partnership](#)
- [Umbrella company](#)
- [Sole trader](#)

Once you have made your decision, it is time to negotiate and sign your first contract. What you need to do at this point depends on your own circumstances and how you have decided to operate. You may need professional advice.

Contract work as a sole trader

Working as a sole trader is a fairly simple option. You need to register as self-employed with HMRC and keep basic accounts, something that PayStream's My CIS service can help with, however the paperwork isn't much compared to what is involved in setting up a limited company. You will have to pay income tax at the same rate as an employed person, plus Class 2 national insurance contributions and possibly Class 4 contributions too.

The main disadvantage of contracting as a sole trader comes when you are looking for work. Most contracting work is arranged through agencies, and agencies can not deal with sole traders. They usually prefer to deal with umbrella companies or with contractors operating through their own limited companies.

The other big disadvantage of working as a sole trader is the liability issue: you are personally liable for any debts your business may incur. You need to consider whether you are prepared to risk this.

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Contract work as a limited company

Operating through a limited company will make it easier for you to get work through agencies. The other big advantage is that, as the name suggests, your liability for any debts incurred by your business is limited. So you won't lose everything if the business fails.

The downside of having your own limited company is that it costs time and money to set up and run. Handling the paperwork isn't easy when you are also trying to get started as a contractor. However, there are companies that can help you with this. For example, PayStream<link to homepage> offers a service called My PSC<link to My PSC page> for contractors outside IR35<link to IR35 guide>. With My PSC<link>, PayStream helps set up the limited company on your behalf and provides ongoing accountancy support.

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Contract work with an umbrella company

Working through an umbrella company such as that offered by PayStream<link to homepage> has many advantages if you are a contractor. If you use an umbrella service such as My Max <link to My Max page> from PayStream <link to homepage>, you become an employee of the umbrella company. That means you don't have to worry about taxes, IR35 compliance <link to IR35 guide> or keeping detailed accounts.

A good umbrella service like My Max <link to My Max page> will invoice clients for you and then handle your PAYE and NI deductions, just like any other employer. That means that the money you receive is yours to keep. It is also possible for umbrella companies to claim tax relief on allowable deductible expenses on your behalf, maximising your take-home pay.

Using an umbrella company will also make it easier to get work through agencies. As we've mentioned <link to sole trader bit>, agencies prefer to deal with umbrella companies or limited companies rather than with sole traders.

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Will I pay less tax as a contractor?

This depends on how you choose to operate. If you are working as a sole trader or through an umbrella company, you will pay the same tax as if you were employed.

The situation is different if you are running a limited company. In this situation, you may be able to minimise your tax bill by paying yourself a low salary and taking the rest of your income in the form of dividends, which are taxed at a different rate and don't attract national insurance. However, this is only possible if you are outside IR35 <link to IR35 guide> and there are risks involved with going down this route. See our IR35 guide for more information.

If you are running a limited company inside IR35 <link to IR35 guide>, you can't take the low salary and dividends route. All your income has to be taken in the form of a salary and taxed as such.

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What are my obligations as a contractor?

You are obliged to keep to the terms agreed in your contract(s) with your agency and/or client.

If you are running your own limited company, you will probably be the director of the company and there are legal obligations connected with this. For example, you must file accurate and timely company accounts. However, not all these duties have to be carried out by you personally. It is possible to use a service such as My PSC <link to page> for your accounting and paperwork obligations.

If you are contracting in the construction industry, you have obligations under CIS <link to CIS generic page>, (the government's Construction Industry Scheme). These obligations involve time-consuming paperwork. However, a CIS service <link to My CIS page> like My CIS <link to My CIS page> can handle these obligations for you.

However you choose to go about contracting, you are obliged to pay any tax due. This usually means completing a tax return, which can take up a lot of your time. However, if you use an umbrella service <link to umbrella service generic page> such as My Max <link to My Max page> from PayStream, you can avoid unnecessary paperwork because the umbrella service acts as an employer for you and pays tax on your behalf.

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What are the risks?

Every kind of work carries some kind of risk. When your current contract ends, there is no guarantee that there will be more work for you in your industry and your contract can be terminated at short notice. That is a risk you take as a contractor.

However, that does not mean that contracting is always the riskier option. Remember that you are not dependent on a single company to earn a living. You could argue that that puts you in a safer position than an employee, who could be dismissed or made redundant by their employer.

Other risks include the very real possibility that you will fail to keep up with your paperwork and end up being fined for failing to do something important, like a tax return or even company accounts. You can reduce the risk of this happening by using an umbrella company like PayStreams' My Max service <link to umbrella company page> or using a limited company service like PayStream's My PSC service <link to limited company page> to help with the paperwork.

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