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CONTRACTORS' HANDBOOK

**THE EXPERT GUIDE FOR
UK CONTRACTORS AND FREELANCERS**

Second Edition

DAVE CHAPLIN

NEW!

Latest Tax & IR35 updates –
including 2012 HMRC guidance

Agency Workers Regulations –
new chapter on how AWR works

When things go wrong –
20 effective new solutions

And much more –
Updates and fresh
new features

Foreword by
John Brazier
PCG

Contractors' Handbook

The expert guide for UK contractors and freelancers

Second edition

Praise for the first edition

Don't even think about embarking into freelancing without ordering a copy of the Contractors' Handbook by Dave Chaplin. You could easily spend years finding out the hard way, what this highly focused and relevant book tells you and, after reading it, you will know exactly how to handle all the pitfalls and joys of contracting.

David Colom

D J Colom & Co Chartered Accountants

I'm finding the handbook to be very interesting and useful, especially as I'm rewriting my CV to a more high impact format. The best part so far has been the recent 'contract renewal' which, having read the handbook, I referred back to my agent to get it redrafted as a new contract with a change of title, and took the opportunity to get an increased rate as well!

Paul Gardner, UK Contractor

Whatever stage you are at with your career in contracting or freelancing, the Contractors' Handbook is an invaluable source of information and hints and tips. The author Dave Chaplin's successful career as a contractor means that he's now able to pass on the secrets of his success. And as a former contractor, I can really relate to the subjects Dave covers in the book; having this available during my contracting career would have been a big help. The Contractor's Handbook lays out everything you need to know about working as a contractor, in a clear and concise fashion, and the format of the book, with Dave's real life examples, make it an easy and enjoyable read.

Rob Crossland

CEO, Parasol Group

Rarely do you pick up a book that answers all the questions. Not only does the Contractors' Handbook answer them in detail, but it also goes into areas I hadn't even thought about – despite creating and running several successful businesses. Whether you are a freelancer, contractor, interim, freelance consultant or locum, regardless of the years you have been working, this comprehensive book is an absolute gem. Get one and I promise you it will remain on your shelf for reference and get used regularly. Highly recommended!

Darren Fell

Managing Director, Crunch

Given the unrelenting change that the freelance and contractor landscape has undergone in recent years, this updated version of the Contractors' Handbook will prove essential reading for first timers and veteran contractors alike. As ever, Dave Chaplin has used his vast experience of the field to help contractors navigate the often confusing and sometimes treacherous path to successful freelancing.

Tony Harris

Managing Director, Contractor Financials

The Contractors' Handbook is a much-needed publication. Contractors want trusted, concise, practical advice, which is exactly what Dave Chaplin provides, at an excellent price. Importantly, the guide also offers reassurance to people considering contracting as a career move, whilst addressing the complex tax and regulatory issues.

James Leckie, Owner, Contract Eye Limited

As a "permie" looking to spend a bit of time contracting, this book pretty much matched exactly what I was looking for and it was well worth investing in the book, and investing the time required to read it properly. I found that for me, the best way to use it was to read the chapters in order, one at a time, and spend a couple of days reflecting on the contents of the chapter and doing my own research into the topic it covered, as a kind of dry run while I was still in my previous job.

NumberSix Amazon review

Really pleased to have read this, and read it I did, from cover to cover, all 500 pages! I'd really just wanted to find out more about keeping out of IR35, what with HMRC going after contractors like me who work through limited companies. But having started, I realised I could have done with this book about four years ago when I began my contracting. Buy the Contractors' Handbook and it will probably save you making costly mistakes by knowing how to avoid bad deals, etc. If you're lucky, like me, it could also help you find your next contract!

IT Jane's Amazon review

I've been thinking about contracting for a year now, and bought this book after a friend recommended it to me. And a great recommendation it was. The author clearly speaks from experience and his "been there, done it" sections offer some really great insightful tips. This book has given me the confidence to finally make the leap to contracting and I'm sure I'll be referring to it often to help me with my contracting career. Worth every penny.

Beks' Amazon review

This is a good introduction to UK IT contracting. I would highly recommend it to anyone new to contracting that wants to quickly grasp the most important aspects of the move from permie to contractor. It will more than pay back the cover price with its advice to new contractors.

Bob Smith's Amazon review

"I've successfully made the transition from permanent employment to working as a contractor. My advice to first-time contractors is buy the Contractors' Handbook and read it thoroughly from cover to cover. Twice. If you're not serious, it'll frighten you off, and if you are serious, it contains a wealth of practical advice from seasoned contractors who've 'been there and done that'."

Ken Burrell, Brilliant Baselines

"At last the information, step-by-step guidance and advice we've all been looking for! After 19 years contracting I thought I was a pro', but the Contractors' Handbook has opened my eyes. I wish I'd had this when I was starting out, but it's just as useful to me now."

Paul Ross, UK contracting veteran

Contractors' Handbook

The expert guide for UK contractors and freelancers

Second edition

Dave Chaplin

CONTRACTOR
CALCULATOR.CO.UK

your expert guide to contracting

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Dedicated to my parents and my dear wife,
for all their love and support.

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The impetus for first edition came from the hundreds of contractors who have sent in queries – from the basic to the bizarre – to the Contractor Doctor on ContractorCalculator.co.uk. Their regular questions help shine a light on current contracting, legislation and tax issues. They have also helped us illuminate some of the darkest corners of contracting legislation, 'worst practice' and even lifestyles! Many people who successfully used the first edition to start or develop their contracting careers have contributed to the second by providing invaluable feedback, which has been duly incorporated into these pages.

Numerous experts within the contracting sector have generously given of their time and freely offered their advice and opinions on the wealth of guides developed on ContractorCalculator.co.uk, and which form the backbone of this book. Some are 'inside sources' who wish to remain anonymous, but my public thanks go, among others, to:

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My wife, father, other loved ones and friends deserve special mention, for their unfailing support and incredible patience during the creation of the second edition.

To all of you, my heartfelt thanks.

Dave

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Foreword to the second edition

By John Brazier
Managing Director
PCG

The strategic importance of contractors and freelancers to ensuring that the UK remains highly competitive in a global economy continues to increase, as has the size and influence of the UK's freelance and contracting sector – both in the UK and the rest of Europe.

PCG research conducted by Kingston University's Small Business Research Centre shows that, since 2008, the UK's flexible workforce has grown by 12% to 1.56 million. Contractors and freelancers now account for one in twenty of the working population. By providing additional skilled labour to increase the capacity of organisations and to bring them fresh insights, contractors and freelancers are making a disproportionately large contribution to rebalancing the UK's economy towards investment and exports.

As their numbers have increased, so has the influence of this vital group of uniquely skilled and flexible knowledge workers. Through the PCG, contractors and freelancers have secured representation at the highest levels of Government and policy making in Westminster through the All Party Parliamentary Group (APPG) on the Freelance Sector. This group is tasked with highlighting the contribution contractors and freelancers make to the UK economy, as well as with drawing attention to the challenges they face and the barriers to their growth.

The UK's knowledge workers are highly mobile. Many UK-based contractors and freelancers deliver their services to clients outside the UK, making their own contribution to Britain's exports. Within Europe, a critical mass of pan-European contractor and freelancer organisations are placing flexible workers at the heart of the policy agenda – both at the European Commission (EC) in Brussels and the European Parliament in Strasbourg.

As well as increasing in number, contractors and freelancers are themselves evolving, adopting new skills and working practices to

ensure they maximise the benefits of new technologies and access to new markets. The flexible workforce's stakeholders, including clients, are becoming increasingly aware of the benefits that contractors and freelancers can bring to their organisations.

Alongside this growth comes a thirst for knowledge on how to flourish as a contractor and maximise the opportunities of the freelance lifestyle. This knowledge comes from representative industry bodies, such as PCG, as well as through websites like ContractorCalculator.co.uk, plus, of course, publications like the *Contractors' Handbook*. And this second edition is particularly timely, as it expertly details the May 2012 changes to how the IR35 tax legislation is administered – perhaps the most significant changes since IR35 was introduced in 1999.

By accessing this knowledge, contractors and freelancers can unleash their true potential, building a firm foundation for launching and managing successful freelance and contracting businesses.

John Brazier

Preface to the second edition

Three years on from the first edition of the *Contractors' Handbook* and the contracting sector has not only survived the worst economic downturn since the end of the Second World War, but also continued to grow and further support UK Plc.

But it has been far from 'business as usual' – much has changed. Indeed, since the Coalition Government came to power in 2010, IR35 (the 'contractor tax') has never been more active. First the government set up the Office of Tax Simplification, for which I and ContractorCalculator consulted extensively. And then the IR35 Forum came along, adding a further layer of complication for limited company contractors to deal with from May 2012, in the form of HMRC's new business entity tests and guidance. Before then, the Agency Workers Regulations (AWR) came into force in Autumn 2011, resulting in changes for many contractors and their recruiters.

But despite these dramatic shifts, much has not changed in the last three years. The hard work, cutting-edge skills, broad experience and flexibility of the key members of the UK's workforce remain the drivers of economic recovery and success – contractors are still the pathfinders of growing businesses and economies. Vital to the success of UK Plc for centuries, highly skilled and flexible contractors have always been found in every sector – from science, engineering and medicine, through crafts and trades, to education, the arts and media.

Research from PCG confirms that the number of contractors in the UK continues to grow; it reached 1.56 million in 2011, up from 1.4 million in 2008. And anecdotal evidence, combined with a 50% rise in ContractorCalculator.co.uk readers since the first *Contractors' Handbook* was published, points to this growth continuing.

This second edition of the *Contractors' Handbook* remains the expert guide for all contractors and freelancers in the UK – whether you're just considering the move into contracting, or have many years of experience, this book can help you. It's a resource that pulls together in one place: my first-hand experience; the wisdom of many successful contractors built up over nearly two decades; the specialist knowledge

of dozens of expert contributors; ContractorCalculator's numerous contractor-focused calculators; plus of course the site's 650+ carefully researched and regularly updated guides.

Independent ABC audits show that in the last three years the readership of ContractorCalculator.co.uk has grown 50% to over 150,000 unique visitors each month. Readers keep coming back, which is not surprising since we have added a huge amount of new material to the website, including our new and very popular Online IR35 Test. This new material is reflected in the size and composition of the second edition of the Handbook, which has been updated with almost 50% new material. Alongside guidance on navigating HMRC's new IR35 administration framework, there is a new chapter on AWR, updates to tax and legislation, new solutions in the 'what to do when things go wrong' chapter and extensive guidance to help contractors from overseas.

So, for those of you who have longed to take control of your destiny and move into contracting, I offer you encouragement and practical 'how to' guidance for your journey. More and more people are choosing contracting as a career choice because of the flexibility it allows. And, regardless of the economic landscape, the best time to go contracting is "right now". For experienced contractors, you'll find information on advanced techniques to really 'up your game'. And should things go wrong along the way, I'll share with you solutions that have been effectively used by me and others.

Most successful contractors remain successful because they recognise that their market is always moving, and maintain their skills accordingly. This book provides another opportunity to do just that, but for the skills that feature less highly on most contractors' radars, but can be even more important than the letters after your name when it comes to winning the best contracts: things like CV writing, contract law, negotiation techniques and key sales and marketing skills. This second edition also features guidance on adopting the contracting mindset, providing clear lessons on how to move on from being an employee and apply the new rule book of contracting to how you manage your finances, how to work with clients and how you resolve challenges.

As a graduate with a maths master's degree, my ambition was to become a teacher; but the lure of the City and its rewards to IT contractors have ensured my goal remains unrealised. However, through ContractorCalculator.co.uk and the *Contractors' Handbook*, I have found other channels to pass on what I have learnt. If you find this second edition helpful, I shall be delighted. And if you don't find what you're looking for, would like to take issue with anything I've written, or have any questions about contracting, then please do get in touch with me through www.contractorshandbook.co.uk.

Dave Chaplin

London, June 2012

1

**Why go
contracting?**

1.1 The main reasons people do it

The decision to move from being a permanent employee to becoming a contractor seems to have been endlessly dramatised. In fact, it's not that big a decision at all. Choosing to become a contractor ranks well below decisions like getting married or deciding on which career to choose.

In fact, if you are reading this, you've probably already made some fairly important decisions about your career, which is why contracting sounds attractive. You may be a programmer with years of experience and already earning good money in a job. Or you may be a recently qualified engineer and wondering whether you should give contracting a try.

After reading on, the choice can only be yours. The question is, do you always want to be asking yourself 'what-if?'. Don't forget that you can always return to the permanent workplace if contracting doesn't suit you. But if you don't take the plunge, you'll never know what you've missed!

Most contractors go down the contracting road for three typical reasons:

- To do the things they really want to do, and this includes taking more time off
- To avoid the things they really don't want to do
- For the money.

'It's not what I want to do anymore'

Actually, it is the second reason that drives many wannabe contractors into the sector, and then keeps them happily embedded in the contractor lifestyle. In their last role as a permanent worker, or permie, something happens to make them think: 'Surely there must be something better out there?'

Many of us get to the stage in our careers when we become as experienced, skilled and technically proficient as we are likely to get in our chosen skill set. This could be in programming, engineering, medicine, marketing or many other disciplines.

Been there, done that!

The catalyst

DAVE SAYS: My decision to go contracting didn't happen overnight. It's the same for most contractors. The final decision is normally made after a 'right that's it!' event. Common ones are false promises that fail to materialise, like not being promoted or receiving a smaller than deserved rise in salary or receiving no rise at all.

I was working for a consultancy firm that sold me on to various banks at twice what they were paying me. Before I finally decided to go contracting I had a frank chat with my firm and told them I was not happy and what I expected from them, which was more money and more training. They promised it, it never happened; so I left.

I was basically a contractor already, but with one agent that I gave 50% of my money to each month. Cutting out the middleman was a no brainer. I made a few enquiries, handed in my notice, and within two weeks had secured a contract that saw my take home pay double overnight.

The common theme, however, is that for most the next stage of progression after reaching a professional or technical pinnacle is into management, which tends to raise two big questions:

1. Do I really want my future career progression to be on the management track? It typically means doing a lot less of what you have previously enjoyed doing, and doing a lot more managing and progressing your career, which becomes an all-consuming end in itself.
2. Having become the most qualified person at what I do, would I want to start at the bottom again, learning a new skill set and being the smallest fish in a bigger pond?

So many potential contractors find themselves being promoted, or not being promoted, either of which can prove frustrating. And typically many highly qualified professionals find themselves sidelined into 'special projects' or doing tasks they really don't enjoy.

This then makes them think about what it is they really want to do.

Now, what can I do that I have always wanted to?

So, having been given a reason to think about taking the contracting route, we then think about the first reason – contractors who go contracting because they get to do what they want to do.

Here is a really important point: contractors are not employed by the organisation that pays them for what they spend their time doing. There is a big difference between being paid as an employee to perform a task and being paid to do a task without being employed. This will be explained in more detail in section 1.3.

Been there, done that!

True flexibility

DAVE SAYS: Cash was the initial front-runner when I was thinking about reasons to go contracting, but the flexibility was what made me never go back to being a permie.

My initial view of contracting was that I'd basically get paid much more for doing pretty much the same thing. But, as you soon learn after you've been contracting for a year or, so there are many more benefits than just the extra cash. Being able to take off much more time, and having the cash to take more holidays are real bonuses.

I love travelling and took many long weekends in places like New York, Las Vegas, Paris and Moscow, often indulging my love of golf along the way. And I still had money left over each month for savings.

The other great bonus was the training. I sent myself on lots of courses and got certifications. I'd been begging my previous employer for this for ages, but it never happened. The director even said to me after I left that the problem with spending money on training people up is that they then leave.

Within a year of leaving I achieved a recently launched Microsoft Certification, and was one of the first 500 in the UK to get it; that never would have happened if I'd stayed at the firm.

The major point of difference is that, as a contractor, as long as you perform, you can do a lot more of what you want to do. It varies between different types of clients and different sectors, but the common theme is that you take control of your work and your work-life balance.

If you are a software developer and have been allocated specific sections of software to develop during the week, and you finish early on Thursday, you could take Friday off. The developer sat next to you who is an employee has to find something else to do to finish their week. Or, to be more precise, they will either be found something else to do or will try and stretch out the job to last the week.

However, it does not always work like that. If a contractor is an offshore safety specialist working on an ongoing drilling project, for instance, they can't just leave for the weekend until their safety role is covered. But you can bet that what they are being paid more than compensates them for working some weekends!

Contractors have a level of flexibility that permanent employees simply do not have. If they can afford it – and many can – contractors can take long periods of time away from work, or they can choose to work particularly hard for a few years to earn enough to retire early. The keyword is **choice**; a contractor really can choose what work to do, when to do it, and how to do it.

This can also work well for contractors with families who want to be able to choose to spend more time with them, particularly if they have young children or perhaps they want to spend time as a carer for a parent or other relative. The increased money contracting brings can make flexible working possible for many with family commitments who might otherwise not be able to work at all.

For the money

In addition to the flexibility contracting gives, and the ability to leave behind the world of office politics, another important reason people choose to become contractors is for the money. And that's not surprising, because contractors typically earn between 20% and 150% more than permanent employees.

Been there, done that!

No false promises

DAVE SAYS: A very attractive aspect of contracting is that you basically get paid for what you do. If you're asked to work overtime or over a weekend you can, and you get paid for it. This is so much better than a permies' firm playing the 'loyalty card' and promising that working extra for free will look good at the next appraisal. I've always preferred hard cash to a pat on the back!

Why do they get paid so much more? It is generally because they are not employees but also because they may, particularly in some key sectors and disciplines, be highly skilled and very rare, in which case market forces contribute to their high rates. As an employee with such skills, even if they're well rewarded, it is not often that an employee's true market value is paid to them, particularly if they have been with a company for a long time.

Employees are expensive and a high risk to employers. They insist on having reasonable wages, pensions and a whole raft of benefits, yet even if they become too ill to work or the work itself dries up for a while, they still have to be paid. Employers also have to pay additional National Insurance Contributions on top of everything else.

Contractors are cheap by comparison and almost always highly cost-effective to use. They are not employed by the company they are contracting for, so don't have the overheads associated with permanent employees. And if they don't work, they don't get paid, whatever the reason. So the result is that contractors get paid more for taking the risk of not being employed. And, as we'll see in later chapters, that need not be much of a risk at all.

But contractors also have a bit of a trick up their sleeves that makes the contracting option so rewarding for so many. As they are not employees, contractors can pay much less tax, meaning that more gross income finds its way into the contractor's bank account. The tax advantages are explained in greater detail in section 1.3.

Been there, done that!

It's not just about the money

DAVE SAYS: Sadly, and unjustifiably, contractors can get a bit of a reputation as being 'money grabbing'. The fact is that whilst they expect to be paid the going market rate, many would rather work on an interesting project that pays less than on a frustrating project that pays more.

Once, two of my friends jacked in high-paying contracts because the firms needing the work done were simply no fun to work for! The first one was a bank that suffered from heavy bureaucracy, making it impossible to move forward quickly. The second was a consultancy whose expectations were unrealistic – they expected to build Rome in a day and it was the contractor's fault if that miracle couldn't be achieved.

Contractors typically go contracting because they hate politics and/or working for bad bosses. Most of them just like to get things done, achieving the goals of the project and adding value to companies along the way.

Contracting can be a great way of life and, with the help of this book, you too can pick up the tips and tricks to make a real success of it.

Why do contractors choose the contracting lifestyle?

- They want to earn more.
- They love the hands-on work they do and want to carry on doing it.
- They have become disillusioned with permanent work.
- They don't like office politics, have heard one too many false promises, and are fed up working for sometimes unappreciative management.
- They don't want to move up the ladder by going into management and finding themselves doing a job they do not enjoy.
- They don't want to move into a role they don't want.
- After many years working really hard, obtaining their valuable skills, they would like to have more holiday than the 20-25 days a year they currently get.
- They'd like to have more time to pursue other interests, hobbies and business opportunities outside of the 9 to 5, including spending more time with families and children.
- They see contracting as a way of earning more money, taking more holidays, and continuing to do what they love doing.

1.2 Profile of the typical contractor

Actually, there is no such thing as a typical contractor. But there is a collection of skills, experience and attributes that makes it possible for people to choose to become a highly successful contractor.

Firstly, there are the hard skills a person must have before they consider going contracting. A successful contractor needs to have a transferable skill that has a proven market demand from clients who need this skill on a one-off basis to complete a specific project.

Been there, done that!

What does a contractor look like?

DAVE SAYS: Not all contractors are the same, but all of the successful contractors I've met have the same traits: first and foremost, they're highly skilled and passionate about their work. They're not afraid to work hard, but they do expect to get paid handsomely for it. They aren't interested in climbing corporate ladders. Contracting gives them a way to do the same thing as they were doing as an employee, but with loads more benefits and the opportunity to earn six-figure salaries.

Most IT, engineering, construction and technical skills, for example, are transferable. So too are those skills, particularly in engineering, surveying, architecture and medicine, where a professional qualification is required to practice.

Although less common now, many IT professionals in the past became highly skilled at developing major organisations' legacy systems. You can be sure that this made them highly respected within their business. But their skills were not in a common computer language and thus not transferable to wider industry.

So the potential contractor's skills must also be in demand by a wide market. In other words, there must be plenty of potential clients out there who need that skill and are therefore prepared to pay well for it.

A budding contractor must also have some hard business skills, although these can be developed, not least through reading books like this one.

However you go about contracting, and however you feel you dislike the thought of it, as a contractor you have to make some business choices for yourself, otherwise you might just as well remain as a permanent employee.

A grasp of marketing, sales, finance and taxation are needed to be a successful contractor, but they are remarkably easy to pick up. We'll cover all of these subjects later in the book.

Softer skills, such as managing and motivating people, also start to become more important, because as a contractor you have to:

- Act as 'account manager' to your client
- Hit the ground running when starting a new contract
- Work with employees of the client, some of whom may feel the higher wages and better conditions contractors enjoy are not deserved
- Work with other contractors, who may well become your best friends and a great source of future contracts.

Most importantly, you have to want to be a contractor. There are so many benefits to the contracting lifestyle, and sometimes hard work is required to maintain those benefits. But there are several hundred thousand people in the UK who have chosen to work as contractors and wouldn't go back to being a permie. Not all of them can be wrong!

1.3 Contracting compared to being a permanent employee

Contracting as we know it today had its roots in the IT boom of the 1980s, although it has now spread to cover virtually every sector. Back then it was typical for someone to leave work on the Friday as a salaried employee and return on the Monday as a full-blown contractor. They could be doing exactly the same job, at the same desk and for the same company, but finding themselves being paid three or more times as much as they had been the week before!

Nowadays the same happens, but the contractor should be working with a different company. That's because contracting with a former employer immediately after leaving them puts the contractor at risk of still being seen by the taxman as 'employed', with the risk of being caught by nasty tax legislation called IR35. This is explained in greater detail in chapter 8.

But there are some important differences when comparing the situations of contractors versus permanent employees, as can be seen in table 2. The contractor may get paid a larger sum, but the permanent employee enjoys a range of benefits that have a hidden cost to the employer. At a glance, table 2 does not appear to greatly favour the contractor. But in the key categories of pay, hours, holidays and tax, being a contractor can far outweigh all the other benefits combined.

Pay

Contractors are paid a gross sum, usually weekly or monthly, and by the hour or day. Day rates can be typically up to £500 per day, increasing to £1,000 per day at the top end of the market. Some very specialist roles can be even more.

Type of contract

The difference between the types of contracts an employee has with their employer and the contract a contractor has with their client is significant:

	Permanent employee (permie)	Contractor
Pay	Standard market rates – much less than contractors or consultants	20% - 100% more than employees
Type of contract	Of service, as an employee. The employer is required to supply paid work during the contract of service and the employee is obliged to accept it	For services as a company. The employer is not required to provide paid work; the contractor only has to do work previously agreed to.
Hours	Usually fixed or limited flexibility	Flexible
Holidays	Paid, 28+ days	Unpaid, flexible
Notice	Usually weeks	No, subject to contract
Redundancy	Minimum statutory	No
Benefits	Yes/statutory	No
Sick pay		
Maternity	Yes/statutory	No
Pension	Yes/stakeholder	No
Private health	Potentially	No
Company car	Potentially	No
Mileage allowance	Potentially	No
Health club	Potentially	No
Staff canteen	Potentially	No
Crèche	Potentially	No
Social events	Potentially	No
Company politics	Yes	No
Promotion worries	Yes	No
Tax and expenses	PAYE, NIC, few allowances	Salary, dividends, high allowances

Table 2 Permanent employee versus Contractor

- An employee-employer contract is a *contract of service*
- A contractor-client contract is a *contract for services*.

Basically, the contractor's contract is just the same type, one for services, as if the client were hiring, say, a grounds maintenance company.

They come in, cut the grass, get paid and move on to their next client's site. The contractor is just another service provider and, as long as the work is completed to the agreed standard, according to budget and schedule, they get paid.

Been there, done that!

No need to work for free

DAVE SAYS: One bank I worked for was in real trouble, having set some crazy deadlines that we were never going to be able to achieve. They pressed hard for the contractors and permies to work twelve-hour days and weekends, which started becoming the norm.

As contractors on daily rates, this wasn't ideal. So the contractors got together and said we weren't going to work for free, and that they had to pay us extra money for the extra work. Given their position and the huge market demand for contractors they had no choice but to pay up.

The permies were promised 'bonuses' after the software was released, which were nowhere near what the contractors were paid. You won't be surprised to hear that quite a few of them went contracting after that!

An employee, with a contract of service, on the other hand, is controlled by their employer. Most permanent employees would not consider themselves as controlled by their employer, but in practice they have signed a contract that says they will do a job, which the employer, within certain limits, can change. They also have to be present at a specific place between certain hours and for certain minimum days of the year.

Another crucial difference is that the employer has what is called a 'mutuality of obligation' with their employees, but not with their

contractors. What mutuality of obligation, or as it is referred to in the contracting sector 'MOO', means is that if the employee keeps their part of the bargain and turns up to work, the employer has to find them some work to do and pay them regardless.

This often means that the permanent employees get a great deal of the less exciting and satisfying work, because contractors rightly refuse to do the work as it was not in the original agreement with the client. An employee can't do this, even if it's not in their job description, because in the real world employees do what they must to secure their next promotion or pay rise, or perhaps even to keep their job.

Been there, done that!

Saying 'no'

DAVE SAYS: During a project for a client, when I was effectively a permie, I was asked to learn some bizarre old programming language for an existing client requirement. Apparently, as my employers put it, knowledge of this tool 'was a great opportunity and would look good on my CV'.

After some research it turned out that it was an almost defunct language that the client required to update some old system they had. Hardly a CV-enhancing skill set to learn. I expressed my dissatisfaction at having to do this, but still had to do it anyway. It was the dullest six months of my career.

During my contracting years I was often asked whilst on site using my up-to-date skills to 'have a look' at some legacy system to quickly help the client out. I always politely refused. I didn't march backwards in my contracting career.

Whilst it might seem odd to be going into these nitty gritty details so early in this book, it is necessary because these key contract points are of vital importance for establishing a contractor's tax status and therefore how much more or less tax they may be liable for.

Hours

Employees are required to work at a specific place or places for a specific number of hours on specific days. Although many employers operate some form of flexi-time, in practice, for most employees, there is little flexibility.

Contractors have no set hours, although there are reasons why contractors may be restricted to working certain hours on some contracts. If for example, key members of the client team were only present during traditional office hours, then the contractor might have to be present during some of those hours to get their work done.

Holidays

Employees, and even temporary workers, have a statutory right to holiday pay. It can vary above the statutory minimum, depending on the generosity of the employer, but is rarely more than 30 days. Contractors, on the other hand, do not enjoy holiday pay; in practice, most simply save some of the extra money they earn as contractors to tide them over the periods they choose not to work, or may not be able to work through illness.

Been there, done that!

Cheap deals are yours for the taking

DAVE SAYS: Getting away is much easier for contractors, because you don't have to worry about managing a fixed holiday allowance. If the project is quiet and you fancy a long weekend, you can take time off. You can then qualify for all those last minute cheap deals.

Contractors may have to plan their holidays around the requirements of clients, particularly workflows associated with the contracts on which they are working. With some planning, this is very easily done; we cover holidays for contractors in chapter 12. Without a doubt contractors, if they choose, can take off much more time than permanent employees.

Notice and redundancy

Neither applies to contractors, although they do to employees. But many contractors would not want the loss of flexibility that comes with being an employee, and therefore entitled to notice and redundancy. Conversely, many employees feel the need to have the cushion of a redundancy payment – no matter how small – if they lose their job. The key lesson for contractors is to put by enough to survive the usually short periods between contracts.

Benefits

As they are not employed by the client, contractors receive no employee benefits. This should not matter, however, as the contractor's extra pay is more than enough to cover these benefits. It also means contractors get to choose the benefits they want, whereas many employees find themselves paying tax on benefits, such as cars and gym membership, that they don't particularly want or need.

Providing some financial cover for periods of sickness is a sensible approach, and not an expensive one, for a contractor to take, and we cover this topic in chapter 12.

Company politics

Every organisation, whether large or small, has politics. If you're a part of that organisation as an employee, you can't help being dragged into office politics. From minor disputes over the right brand of coffee in a small business, to trans-corporation battles between departmental leviathans over billions in capital investment, for most of us politics are a pain that causes untold stress inside and outside work.

Contractors, of course, do not work for the company and, except for minor things like understanding job requirements and getting timesheets signed, do not take orders from, or come under the thumb of, the company's management.

During the research for this book, company politics was one of the most common reasons cited by contractors as to why they left their full time permanent job to become a contractor.

Been there, done that!

Getting ill

DAVE SAYS: In all my years of contracting I think the longest time I took off ill was 3 days, when I had to go into hospital for an operation. I still would have gone into work if it wasn't for the fact that the op' was on my leg, so I couldn't physically get into the office!

You'll see more contractors at work with various sniffles and ailments than permies because they don't get paid if they don't go in to work. I rarely called in sick, but was once ordered home to rest after falling asleep at the desk when a virus zapped me of energy for a week!

It's not that contractors have to work when they're feeling unwell, it's more to do with the fact that they're likely to be doing work they enjoy, and that they'd rather do that and get paid than watch daytime TV.

Promotion worries

Most organisations base pay and benefits on some form of rank within their infrastructure. Promotion for most employees is often the only way to improve their lot. But there can never be more managers than workers, so promotion opportunities are generally hard-fought contests, frequently with good doses of constant pressure and unpleasantness.

Why should contractors worry about promotion if they don't work for the client? They'll be off to the next higher paying contract in a few months anyway, so there is no need at all to get involved in anyone's power play or disputes. Contractors who want to promote themselves can simply take the opportunity to win a contract with a better rate, and buy the 'manager's perks' with the difference.

Tax

Employees generally work on the Pay as You Earn (PAYE) tax scheme with their employer arranging to deduct their income tax and National Insurance Contributions at source. There are very few deductions employees can claim to reduce their tax payments, so

they often face the double whammy of not only earning less than contractors, but also paying more tax than them.

One of the major advantages that most contractors enjoy is that they do not collect pay taxed at source under a PAYE scheme. Contractors who opt to provide their services through a limited company can divert the income from the company in a variety of beneficial ways, such as dividends for themselves and payments into their pension funds, which employees are unable to do.

Another major advantage for contractors using their own company is that they can charge expenses against the business, which means that technically they make less profit, but as a result they also pay less tax. Plus, if they earn enough, which most do, they can register for VAT and claim VAT back on their costs.

Tax advantages

Here's a classic example of the tax advantages of buying work equipment as a contractor:

To buy £2,400 (including VAT) of new computer equipment, the cost to the contractor's company would only be £2,000, because the VAT can be reclaimed. The remaining £2,000 would be tax deductible so a contractor on higher rate tax would only see a net reduction in take home pay of £1,200.

If the £2,400 of computer equipment was bought and paid for with a contractor's net pay, the extra earnings would need to be £4,000. That's because corporation tax at 20%, £800, should be added, and dividend tax of 25%, £800, on the resulting £3,200 dividend should also be paid.

The net result is that buying equipment via a company ex-VAT with pre-taxed income is much more tax efficient and cost effective.

Some contractors find themselves better suited to working through what are known as umbrella companies, which give them official 'employee' status and therefore deduct tax and National Insurance Contributions at source. Such contractors do take home less net income than they might otherwise, but there are some tax advantages with expenses, which means they're still better off compared to permies.

Chapter 6, How to set up and run your business, takes you through your trading options in detail. It also gives example calculations showing how financially better off contractors can be compared to employees.

1.4 Common contracting myths

Not surprisingly for a sector that has grown so rapidly in such a short time, there are many myths about contracting and contractors that might discourage a permanent employee from taking the plunge. However, like most myths, they can be debunked. Here are some of the more common contracting myths:

Contractors' income is not much higher than permanent workers receive

The fees earned by contractors should always be more than permanent employees earn; much more. Provided you take a professional approach to finding contracts you will avoid gaps between contracts and should, if you follow the steps in this book, make considerably more money than you could in permanent employment.

If your skill set is heavily in demand then you could at least double or even triple your current take home pay by going contracting.

Your skills will become outdated

A common fear is that after a year or so your skills will become outdated or even redundant. Some worry that without the training an employer might arrange for an employee, it will not be possible to update the contractor's skills and that contractor will then find it hard to get work. Some contractors do have this problem, but no more so than permanent employees who also don't invest time in training.

Plus, of course, contractors have all the benefits of having developed their skills at a number of different companies, so they often have knowledge and abilities way in advance of permanent employees who have mainly worked for one or two companies for a long time. Permanent employees who have had only one or two jobs over many years are the ones who find it hardest to make the transition to contracting. Change is very healthy, for contractors and permies alike.

Been there, done that!

Skills don't become outdated

DAVE SAYS: When I worked at a consultancy that 'body-shopped' me out and made a nice profit, this was the standard line they told us: "Sure, you'll make lots of money in the short term, but when your skills become out of date no one will hire you."

Well, this proved to be inaccurate. You learn new skills on the job, and many of them are timeless and transferable. For me in IT, sure I had to learn new versions of software, but provided you jump onto the ship before it sails you'll be fine.

Remember that the permanent people tend not to get much training from their firms, so even if you send yourself on a course you are still a valuable commodity whilst the industry is transferring to the new product.

A common strategy to learn new skills is to learn them on your existing contract, so that you have actual commercial experience which you can take to the next one. Treat your contracts like stepping stones. This might require sending yourself on a training course, and a bit of midnight oil burning at home getting up to speed, but it's not the whole time and you are rewarded very well for it.

Contractors who work hard to keep their skills updated rarely experience problems finding work. Contractors also have the luxury of being in complete control of their professional development. They can attend as many courses as they wish, in addition to investing regularly in the latest professional books and manuals, whereas permies frequently have to beg managers for training with all sorts of restrictions and payback clauses added to their contracts in the event they leave their employer.

You are given all the boring work to do

It is true, there are some contracts that nobody would want to do, but the simple solution is not to apply for the contract, or not to accept it when it is offered to you. Remember, contractors aren't told what to do by the manager, like permanent employees. On the contrary, contractors choose what projects they want to work on.

Should a contractor be asked during a contract to complete something that is outside the bounds of the original contractual agreement, then the contractor is not obliged to do it and, in most cases, shouldn't even think about doing it. If things become untenable (which is very rare) the contractor can simply leave, then sue the client for breach of contract, which is not as difficult or expensive as it sounds (see chapter 10).

You do not get benefits – sick pay / holidays / health insurance / company cars

We've already covered this topic and we know that it is true. However, as their own employer, contractors can buy all the benefits they want. And, interestingly, many contractors find themselves taking fewer days off sick; not because they're working through their illness, but because they're enjoying what they do and don't tend to feel the 'Monday blues'.

Health insurance is available for contractors, and can guard against long periods of time off work due to sickness. Company cars benefit employees who would not normally be able to afford such a model themselves, and therefore cost significant amounts of extra tax. But it is much cheaper for an individual to purchase and fund their own car, and most contractors very quickly amass the disposable income to buy exactly the model they want.

You cannot get a mortgage without two years worth of accounts

Contractors can access specialist financial services products, such as mortgages, created specifically for them. In fact, because some lenders recognise the earning potential and higher net pay of the contracting model, contractors often secure better deals than those available to permanent employees. Plus, with the additional money contractors are earning, they can also make overpayments and clear mortgage balances in less time.

You are liable for costly errors in your work.

It is true that contractors, as service providers, are liable for any errors they make, but so are professionals like lawyers and accountants. To mitigate this risk, most limited company contractors simply purchase their own professional indemnity (PI) insurance, whilst umbrella company contractors are generally covered by their

umbrella's PI insurance (the differences between these contracting styles is described later in the book). Just like any other insurance, it is there to protect the contractor in case a client makes a claim against them.

It's a hassle setting up a company and doing all the accounts

A contractor can buy a new company online in less than half an hour for around £20. Most contractors work with accountants or umbrella companies that handle the vast majority of record keeping, accounting and tax return preparation online.

Contractors usually only have to keep accurate invoicing, timesheet and expenses records, not much more than they would as a permanent employee. In fact, some contractors might find running their own company simpler and less painful than extracting expenses from their former employer!

The hardest part about contracting is making the decision to leave the perceived comfort and security of permanent work to go and get that first contract.

Once that decision has been made, most wonder why they didn't choose to become a contractor years before. Perhaps they were waiting for this book to be published!

Been there, done that!

Guest house heaven

DAVE SAYS: One of my friends was sensible enough to save his money when he was contracting, a hard task for any young and single person working in London, where there is plenty of opportunity to party.

After five years he gave up the rat race, moved to Scotland and bought a guest house. He now spends the morning attending to guests, the afternoons playing golf and the evenings with his family. If you plan well you, too, can buy yourself out of the daily grind.

Contracting lessons from this chapter

- Contracting offers you choice. You can choose what contracts you wish to accept and you can choose to avoid work that does not interest you.
- Contracting enables you to earn more money. Often much more.
- Contractors have much greater control over their careers.
- You can become a contractor if you have a recognisable transferable skill set that is in demand.
- Many contractors chose to go contracting because they can continue doing what they enjoy most for more money, without climbing the management ladder and moving away from their skill set.
- Your increased earnings and company structure should more than make up for the lack of employment benefits.
- Not only can you maintain your skills when contracting, but you can also greatly enhance them.
- Office politics are minimised for contractors.
- Contractors can take much more holiday than permanent employees.
- Contractors don't work for promises. They just get paid. Simple.

