

# A Guide to Contracting for IT professionals

By Simply Business

More and more professionals are turning to contracting from full-time employment. Higher pay and flexible working hours are tempting, even when the economy is in difficulty.

This guide to IT contracting will help those who want to make the leap from 9-to-5 employment into self-employment; explaining key areas such as IR35, self-promotion and getting contracts.

# Introduction

Becoming a contractor can be a very attractive prospect, especially in the technology sector. For many people, this type of work provides the perfect balance between being your own boss and enjoying some of the security offered by a more conventional working arrangement. IT consultancy fees can also be very rewarding.

However, contracting isn't for everyone. There is a significant amount of extra work involved with this lifestyle that regular employees do not have to suffer. Furthermore, work is rarely guaranteed and many people cannot do without the steady reassurance of regular employment.

This guide will help both those who are considering becoming an IT contractor and who have already got started. It explains exactly what being a contractor entails, and gives some vital information to help ensure your new life as an independent worker is a success.

# What is a contractor?

From the outset, it is important to understand that IT contractors are distinct from employees. A contractor provides IT services to a specific client under specific terms. In contrast to being an employee, IT contractors can have control over when and where they do the work - subject to their contract - however the nature of the job usually involves working on a client site. Contractors are paid for the work they complete, whereas employees are paid for the hours they put in.

It is frequently presumed that contractors work on a never ending series of short-term projects. However, that is not necessarily the case. It is not unusual for a contractor to remain with the same client indefinitely.

Indeed, many contractors are actually employees in all but name. While this has its upsides (the client need not make National Insurance or pension contributions, while the contractor retains some control over their schedule), HM Revenue and Customs take a rather dim view of these arrangements. The punitive tax implications of 'disguised employment' are explained later in this guide.

## Is IT Contracting right for me?

Contracting has a number of significant benefits. For many people, the primary attraction is the ability to set their own schedule. Furthermore, contractors have significantly more freedom regarding the work that they do or do not take on; they are not obliged to accept a contract, and will have a precise idea of the work that is entailed before they begin the job. Finally, if the contractor manages their finances efficiently, they can enjoy significant tax advantages.

However, contracting also presents some drawbacks that must be considered. Primary amongst these is the lack of any employment rights. While employees are generally entitled to redundancy pay, holiday and paid sick days, contractors are very much on their own. Clients may choose not to renew contracts and, unless a breach of contract has occurred, there is nothing a contractor can do. As such, contracting is a more precarious life than that of an employee. This lack of stability discourages many would-be contractors. However, with good organisational skills and a talent for marketing yourself, there is no reason why contracting should not be a perfectly viable choice.

Your decision as to whether or not contracting is the best option for you is likely to be dictated by your circumstances. For example, while many people make a very respectable living from contracting, you may feel that you require the security of conventional employment. This is particularly true for those with families and a mortgage.

That said, you can find long-term IT contracts that offer much of the security of conventional employment, along with the benefits of the contractor's lifestyle. Often IT contractors can command a higher salary because the employer does not pay tax, national insurance or pension contributions and does not have to include other benefits that they give to employees such as car allowance or health insurance.

# Getting started as an IT contractor

Starting out as a contractor can be a daunting experience, particularly if you are moving straight from regular employment. The extra work required can seem extreme; you must market yourself, find and negotiate contracts, look after your tax and annual returns - and, of course, do the work you are contracted to do.

However, once you are into the swing of your new life as a contractor, you are likely to find that it is not as difficult as you first imagined. Getting yourself organised from the outset can help ensure that, further down the line, you are free to work and find contracts rather than flailing around in a tangle of paperwork.

## Legal structures for contractors

Deciding on a suitable legal structure should be one of your first tasks when starting out as a contractor. This decision will, to an extent, depend on whether or not your contracts are likely to fall within the IR35 rules. IR35 is the bane of many a contractor's life, and it is vital that you understand its implications for you.

### What is IR35?

IR35 was announced in 1999, and came into force in April 2000. It is legislation that effectively allows HM Revenue and Customs to treat some contractors as employees, and tax them accordingly, when they judge that they are employees in all but name.

The original purpose of IR35 was to prevent highly paid employees becoming self-employed 'contractors' in order to mitigate a tax and National Insurance burden but, to all intents and purposes, carrying on in employment exactly as they had been. However, IR35 has had significant and detrimental effects for other, perfectly legitimate contractors.

IR35 allows HMRC to 'construct' a contract of employment where they judge a contractor is, in fact, an employee. If your contract is deemed to fall 'within' IR35, you could see your post-tax earnings reduced by up to 25 per cent. More information on working out when you are affected by IR35, and how to avoid it, can be found later in this guide.

The legal structure under which you operate will have an effect on your IR35 position. While it will not affect the nature of the contracts you take on, it could affect your take-home pay. Your choice of legal structure should be thought of as a choice between payment processes, rather than a decision that will have any effect on your contracts themselves.

Broadly speaking, you have two main options: you can form your own limited company, or you can use an 'umbrella company'.

## Forming a limited company

For most long-term contractors, forming a limited company is the most cost effective option. While it involves a fairly significant initial time investment, the potential benefits down the line should be fully considered.

As Director of a limited company, you will have complete control over the day to day affairs of your business. This has a number of advantages; primary amongst these is the fact that there is no middle-man through which you must be paid. This can save valuable time and help to ease your cashflow.

A limited company is also valuable if you wish to give the impression that you are not just a one-man-band. For example, when applying for large contracts it may be in your interest to give the sense that yours is an established or sizeable organisation. A limited company with a 'respectable' registered address (which is included in many company formation packages) can help give a good first impression.

## Using an umbrella company

The second option is to use the services provided by existing 'umbrella companies'. These are simple to find, and beginning a relationship with one requires little of the work associated with establishing and running a limited company.

On a basic level, umbrella companies are a means by which you can outsource your payroll requirements. Rather than being paid directly by your clients, your payment would be processed by the umbrella company. You would submit a timesheet to the umbrella company, who would bill the client. The umbrella company would deal with all accountancy and tax issues, and all of your income would be treated as if it were a conventional salary.

Clearly, there is significantly less work involved for those who choose to go down the umbrella company route. However, there are a number of significant drawbacks.

Primarily, the tax burden for contractors who use umbrella companies is far higher than for those who become company directors. All salary drawn through an umbrella company is subject to employer's and employee's National Insurance, as well as NI Contributions.

## Limited companies, umbrella companies and IR35

While your choice of legal structure will not have any effect on the legal status of your contracts, it will have a significant effect on your tax liabilities. If you choose to use an umbrella company, your contracts will be treated for tax purposes as if they are all inside IR35 - even if, in a legal sense, they fall outside the legislation. As a result, long-term contractors will almost always be better off forming their own company, rather than using an umbrella.

# Tax and accounting

Regardless of your choice of legal structure, you will still have some responsibilities and liabilities when it comes to tax and accounting.

If you opt to use an umbrella company to take care of your payment arrangements, your responsibilities will be limited. Tax will be deducted at source, so you will generally not be required to complete an annual self assessment. However, your liabilities will be far higher than if you ran your own limited company and had contracts that fell outside IR35.

On the other hand, if you choose to set up your own limited company, you will be faced with a significant paperwork burden. You will need to complete annual company accounts, as well as your own self assessment. Furthermore, you will need to ensure that your books are kept in order. You will be responsible for your own tax payments, and you must therefore keep accurate records of money in and money out.

There is a clear financial benefit to running your own limited company, however. Assuming that you can negotiate IR35-compliant contracts, you will pay considerably less tax than you would under an umbrella company. Furthermore, you can offset the cost of business expenses against your tax liabilities, further lowering your annual tax bill.

## What is Section 660?

Along with IR35, Section 660 is amongst the most important pieces of legislation affecting contractors. It should be given consideration when you are negotiating contracts and arranging your tax affairs. Luckily, those who are caught by IR35 will not be affected by Section 660.

Section 660 targets individuals who transfer portions of their income to another individual (for example a spouse or partner) through the use of dividends. This technique is frequently used to reduce a tax burden.

Transfers like these are known as “settlements.” They are common; many contractors have set up limited companies with two directors, the second director normally being their spouse or partner. Part of the income derived by the individual who is earning is then allocated to the non-earning partner, normally by way of tax-efficient dividends.

If you currently have an arrangement like this and you are a higher rate taxpayer, you are at risk from a potential HMRC investigation. Worst of all, HMRC can apply the law retrospectively; they can look at your arrangements for the previous six years, and hand you a bill.

If you think you may be caught by Section 660 it is vital that you seek professional advice.

# IT Contractor insurance

Insurance should be amongst the top priorities for IT contractors. Due to the risky nature of a job where you are responsible for a client's IT infrastructure at some level, it is important to be covered in case of mistakes. IT employees have the protection of their employer's insurance but contractors must make their own arrangements.

A comprehensive insurance policy that includes professional indemnity cover will help maintain the stability of your business in the event of compensation claims resulting from mistakes in your work that have caused the client a financial loss. The clients will also see from your insurance cover that you are conscientious and you may therefore be a more attractive prospect.

The main insurance covers that IT contractors would buy are:

## Professional indemnity

There is always room for error when people are involved and this can especially be the case in the IT sector. Regardless of an IT professional's experience and knowledge mistakes can happen, and as an independent contractor you have a responsibility to mitigate any damage that your actions may cause.

Professional indemnity insurance helps you cover the costs of any claims made against you in the event that your actions result in a financial loss for your client. A policy from Simply Business will cover the costs of the claim itself, along with any reasonable expenditure that you suffer as a result of your defence of the claim.

If you are uninsured or underinsured, you run a very serious risk of being bankrupted by a compensation claim. Professional indemnity insurance can safeguard you against this possibility.

## Public liability

Most contractors, including those in IT, take out public liability insurance.

Public liability insurance helps to cover the potentially crippling costs of claims made against you by members of the public or clients for injury to them or damage to their property.

If, for example, while working on a client site you built a faulty computer which caused an electrical spark and resulted in a fire, you would be liable to pay for the damage. This could land you with a bill for thousands of pounds in compensation. Public liability insurance is therefore essential if any part of your business is public-facing.

It is also important to remember that many organisations demand a minimum level of public liability cover before they will consider a contractor. It is generally considered that a minimum level of cover for most contractors is £2 million. However, if you are working in the public sector you are likely to find that you require cover of up to £10 million in order to secure contracts.

## Tools and equipment

IT contractors inevitably collect a lot of tools and computing equipment which are vital to their jobs. Computer equipment especially can be expensive to replace and items like hard drives can be damaged fairly easily.

Tools cover will ensure that you have the money to replace tools and equipment that has been lost, stolen or damaged.

## Buying your insurance

With Simply Business you can tailor a policy to your individual needs using our simple form and compare quotes from a range of insurers. Buying online is quick and easy and our UK contact centre staff are on hand to help if you have a question.

To compare quotes now, visit:  
<http://www.simplybusiness.co.uk/>

# Finding contracts

Having engrossed yourself in the legwork involved in becoming a first-time contractor, it is easy to forget that the purpose of all this effort is to find and secure work.

## Marketing yourself

As an independent IT contractor, you must have the skills to market yourself. It may seem counter-intuitive, but it is not necessarily the best or most experienced contractors that get the most lucrative contracts. You could be the world expert in your IT field, but unless you know how to translate that expertise and knowledge into something that potential clients will understand and appreciate, you will not fulfil your earning potential.

You must learn how to sell yourself.

Ultimately, you need to persuade a potential client that they are better off giving their cash to you than to anyone else. In order to achieve this, you may find it useful to look at some of the tricks used by professional salespeople. Primary among these is an ability to focus on the needs of the client. They are interested not in you, but in what you can do for them. This should be the strongest thread running through your sales pitch.

Many contractors find that professional sales training is beneficial. There are numerous courses available that should equip you with the skills you need to sell yourself. These courses can be particularly beneficial if you have no previous sales experience.

## Writing an IT contractor's CV

Writing an effective CV is amongst the most important elements of your marketing effort. If you are the product, then your CV is the initial pitch. Most potential clients will spend less than a minute looking at your CV, and you will not be invited in for an interview unless it impresses immediately.

As a result, 'narrative' CVs - those that describe your career path in a linear way - tend not to be successful for contractors. Rather than a timeline, your CV should read like an explanation of your key skills and qualifications, with evidence and information about where and how you have demonstrated them.

It is also vitally important that you tailor your CV to the specific contract for which you are applying. A generic CV sent out to every potential client is easily spotted, and is likely to be discarded out of hand. Furthermore, a generic document will not demonstrate your suitability for each specific job for which you apply. The extra few minutes that it will take you to write a 'targeted' CV may well make the difference a successful application and a wasted stamp.

## Should I use an agent?

Finding IT contracts to apply for can be a difficult task, especially in a field where the competition is fierce. A trawl around the regular job search websites is unlikely to yield anything other than full-time employment, and many contractors simply don't know where to find the contracts they need. This is where agents come into their own.

Many IT contractors use agencies to find them potential clients. This has some clear benefits; agencies specialising in IT should have advance information about available jobs, and will be the first to know when new contracts arise. Indeed, many companies have exclusive deals with agents, meaning that they will only take on contractors who come through their specific agency partner.

Agents will generally charge the client at least 12 per cent more than your actual fee. In theory, use of an agency should not result in a reduction of your pay. In reality, however, agents will pressure you into negotiating a rate that is mutually acceptable. The key thing to remember is that agents have no interest in your career past their commission. As such, your negotiation skills will need to be sharp.

There are a number of tips to remember when negotiating your rate. To begin with, it is important to understand that you are in the best bargaining position after an interview - providing, of course, that the interview went well. Your agent will suggest a rate prior to the interview. Even if you have agreed to this rate in principle, you should insist on more afterwards.

If you have been offered the contract, the agent will be more interested in bringing in at least some income than to risk losing the commission completely. A particularly effective technique is to suggest that, having attended the interview, you have realised that the position is more labour-intensive than you had previously thought, and that you should therefore increase your rate.

While this may seem combative, it is important to remember that both you and the agent are out to make as much from each contract as possible. In this way, contractor and agent should have a symbiotic relationship - albeit one in which you are not afraid to stand your ground.

## Finding public sector contracts

Many contractors concentrate all their efforts on seeking out private sector contracts. While this does constitute the bulk of most contractors' work, the public sector contracts should not be underestimated. They represent a significant source of revenue, and one that is generally unaffected by the economic pressures that may reduce the volume of work available in the private sector.

Public sector contracts can seem out of the reach of most independent IT contractors. However, it is important to note that the government and its various agencies put jobs of all sizes out to tender.

The government has recently taken steps to ensure that applying for public sector contracts is as easy as possible. The new Supply2 website acts as a directory through which IT contractors can find vacancies for which they might be suitable. It lists "lower-value contract opportunities"; that is, contracts with a value of

£100,000 or less. Contracts of a higher value will be virtually impossible for an independent contractor to carry out.

The public sector procurement process requires the government to ensure that they are getting the best possible value for money from their contracts. As a result, the process of applying for public sector contracts is rather more drawn out than the equivalent process in the private sector.

Some contracts will require 'pre-qualification', whereby the buyer will determine whether or not you are broadly suitable for the position. This will generally involve you providing details of your past work and financial situation. If this is successful, you will be sent an Invitation to Tender (ITT). Your reply should include a realistic bid that you think the buyer is likely to accept; there is no guarantee of any further negotiation after this point, particularly in the case of very low value contracts.

If you are unsuccessful in your bid, you should always seek feedback from the buyer. The buyer's acceptance of a bid is always followed by a 'standstill period' during which unsuccessful applicants can get information on why their bids failed. This is particularly useful for first-time contractors and those who are just moving into the public sector; the new process can be confusing, and feedback from the relevant parties should be valuable.

### **Insurance for public sector contractors**

Most public sector buyers require their contractors to have a higher level of public liability insurance than is expected in the private sector. While most private sector companies will expect cover of £2 million, public sector contracts frequently require cover up to £10 million. Simply Business provides high-cover public liability insurance designed with public sector contracts in mind.

# Legal issues and negotiating contracts

Regardless of whether you use an agency or not, you will require some knowledge of contract law and the ability to negotiate a suitable agreement. IR35 should be at the forefront of your mind throughout this process if you are to keep as much as possible of your packet out of the clutches of the taxman.

## Negotiating a contract - the basics

On the most basic level, any agreement reached with a client must make clear that you are a contractor and not an employee. This distinction should be clear in both the contract and your *modus operandi*.

Primarily, your contract should define exactly what you are agreeing to do for the client. In contrast to an employee, whose work may not be defined at all in the contract, you must make sure that the document clearly lays out the service or services that you are to provide.

Unless the contract is particularly short, it is likely that you will want to be paid at intervals during the course of the project. This is another key distinction between employees and contractors; while employees are generally paid monthly, you should be paid on completion of specific 'milestones', which should be defined in the contract. This is particularly important for IR35 purposes; in the event of an investigation by HMRC, your payment arrangements will be closely scrutinised.

Although the client will probably have a clear idea of the 'deliverables' that they require, an important aspect of contracting is that it is up to you to decide how and where the work is done. Your contract can stipulate that you have the freedom to complete the work in a manner and location of your choice; your working patterns cannot be defined by the client. Again, this is vital in terms of IR35 compliance.

The right of the contractor to determine their own working patterns is an intrinsic part of the distinction between employee and contractor. In legal terms, employees sign a 'contract *of* service', while contractors sign a 'contract *for* services'. In a contract for services, the contractor agrees to provide services to the client in accordance with a previously arranged schedule. The contractor is expected to complete the agreed project to the standard stipulated in the contract, and assumes liability for any errors or omissions - hence the importance of insurance.

'Mutuality of obligation' is another area to which you should devote significant attention. In an employment contract, the employer is obliged to provide work and the employee is obliged to accept it. In a contract for services, however, there is no such obligation; once the project outlined in the contract has been completed, the client does not have to offer you any more work. If the client does choose to give you more work, you do not have to take it. This must be clearly stipulated in the contract, in order to clarify your position and ensure that the arrangement is IR35 compliant.

Above all, you should avoid any 'standard' contracts that might be offered to you. These will almost never pass IR35, and can leave you exposed to unfair clauses and stipulations. Similarly, if there is anything in a contract that you do not understand or are not comfortable with, you should refuse to sign. It is far better to have the offending clauses renegotiated or removed - or, in extremis, to simply refuse the job - than to end up fighting it out in court at a later date.

## Agency contracts

Contractors need to consider certain other factors when negotiating contracts with agencies. Primary amongst these is the 'restrictive covenant.' These clauses attempt to prevent you taking on any further work direct from the client, thereby cutting out the agency. Agencies will generally insist on leaving these clauses in. However, some less scrupulous agencies will attempt to include unnecessarily wide-ranging restrictive covenants that place unfair restrictions on the work that you can take on. Generally, a restrictive covenant should apply only to the specific company with which you are doing business - not to any parent or subsidiary companies.

## Contract renewals

As explained above, you are never obliged to accept an extension or renewal of your contract. Many agencies will attempt to pressure you into accepting an extension, simply because it is easy commission. You should remember that you are under no obligation to take it. However, if such an offer is made, you are well within your rights to accept it.

If you know in advance that a renewal will be offered, and that you wish to take it, you should start negotiating as early as possible. If your contract is between you and the client, this should not be difficult; unless the client is experiencing financial difficulties (or simply chancing their arm), more often than not you will be able to renew the contract on the same terms - if that is what you want.

However, if you are contracting through an agency you may well find yourself pressured into accepting less attractive terms. The agency may want to increase their margin, or they may want to reduce the rate they are charging the client in order to ensure that they retain the contract. Sadly, there is little you can do in these circumstances save standing your ground. However, by renegotiating early you stand the best possible chance of renewing the contract on mutually acceptable terms.

## Contract terminations

Your contract should clearly set out the way in which termination will be governed. As a result of the lack of mutuality of obligation, you do not have to accept any extension of your contract unless you want to. There are, however, occasional exceptions to this; some agents will insist on clauses that will oblige you to renew your contract in the event that a project overruns. These clauses should be avoided wherever possible and, if you have to accept them, you should make sure that you have the right to renegotiate your pay at regular intervals.

Many clients and agents will pressure you into renewing a contract when you have no contractual obligation to do so. Agents are particularly pushy about this; less scrupulous agents may try to persuade you that you are obliged to renew, or that you will find it difficult to get work in the future if you leave your position. You should stick to your guns in these circumstances; the law is on your side.

It is also important to remember that either party can terminate the agreement immediately if a breach of contract has occurred. This might involve a client's failure to pay, or their failure to provide a safe working environment.

True and clear breach of contract occurs relatively infrequently. You should always seek legal advice before beginning a termination on the grounds of breach of contract, in order to avoid unpleasant repercussions.

# When you are out of work

Sadly, many contractors go through periods during which they cannot secure work. However, contractors are generally encouraged to plan for these periods in advance; they should be thought of as an occupational hazard and, where possible, you should put money aside to tide yourself over. Most experts suggest that contractors should avoid getting on the benefits treadmill.

Claiming Jobseekers' Allowance as a contractor is very difficult as, in the eyes of the Department for Work and Pensions (DWP), your employment status is vague. The situation is complex regardless of whether you contract through an umbrella or run your own limited company; the DWP may treat you as an employee if you have an arrangement with an umbrella, thus requiring you to break off the relationship if you wish to claim benefits. On the other hand, you may well be forced to liquidate your company if you are a Director. Clearly, neither course of action is desirable.

Where possible it is therefore always better to keep a 'slush fund' so that you can pay the bills when you are between contracts. Ideally this fund should be the equivalent of 3 to 6 months' pay.

# Summary

Moving from employment to contracting is a huge step. On one hand you are giving up a significant degree of stability, along with the basic employment rights enjoyed by the majority of workers in this country. It is this lack of stability that puts off many potential contractors.

However, looked at another way, IT contracting can offer the opportunity to increase income, flexibility and to gain a better work-life balance. The agility required and facilitated by a career in contracting can help ensure that you are better placed to navigate the ever-changing economic landscape; in this way, contracting could actually be seen as a more secure choice than conventional employment.

However, in order to make a success of contracting you must be able to deal with the administrative burden. Furthermore, you must ensure that you decide on a suitable legal structure from the outset in order to get yourself on the best possible official footing.

Moving into IT contracting could be a hugely beneficial career move. Get the basics right and start with a solid, suitable foundation, and it could be the best decision you ever make.