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Chartered Financial Planners

Financial planning for the self-employed

Get your finances in order before you go self-employed.



Organising your finances can be a daunting task for anyone, but it's particularly important for those who are self-employed. If you fall into that bracket you will be familiar with having to sort your own national insurance contributions (NICs) and, if you're well organised, paying into a private pension.

An increasing amount of workers are choosing to be self-employed. Figures from the Office for National Statistics reveal the number increased to 4.8 million in April 2017, compared to 3.8 million in 2008, but there are growing fears many of this band are not planning for their retirement.

If you think it's time to start taking control of your finances, it's important to develop a good understanding of your options. Here are a few things to consider.

Planning your finances

National insurance contributions

The first port of call should be registering to pay class 2 and class 4 NICs with HMRC. You can expect to pay class 2 NICs if your profits are more than £6,025 in 2017/18 and class 4 NICs if your profits exceed £8,164.

Class of NICs	Rates for 2017/18
Class 2*	£2.85 a week
Class 4	9% on profits between £8,164 and £45,000 2% on profits of more than £45,000

*Class 2 NICs will be abolished from April 2018 onwards.

Paying these will also ensure they count towards your state pension. However, recent changes to the state pension require you to have 35 qualifying years of NICs to get the full basic entitlement.

Emergency funds

Saving for a rainy day has become somewhat of a cliché, but it's worth setting aside emergency cash each month to cover your outgoings for three to six months so you can survive without income. In addition, most self-employed workers will be paid gross (before tax) and the onus is on you to pay the taxman – both to pay your income tax and NICs. Make sure you store cash away over the course of the year to pay your tax bill and avoid dipping into your emergency funds.

Income and expenses budgets

Keeping a close eye on your business' income and expenditure will help you gain a better understanding of your finances and ensure you stick to a budget over a certain period of time. Adopting this method should ensure there is always enough money to pay expenses when they are due, as running out of cash will threaten the survival of your business.

Income protection

Other factors to consider are taking out income protection and critical illness cover. The former pays out a monthly income if you are unable to work because of sickness up to the age of 65, while the latter pays out a lump sum if you are diagnosed with a specific illness.

Saving into pensions

A report from Aegon shows 52% of self-employed workers in the UK do not have a retirement plan, while additional research from the Federation of Small Business reveals only 31% are saving into a pension and a further 15% claim they have no retirement savings whatsoever.



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Before becoming self-employed, you may have previously belonged to a company pension scheme or been automatically enrolled into a workplace pension with your employer also contributing.

However, with employer contributions stopping, there will be a significant shortfall in terms of your pension contributions if you've gone self-employed. Therefore, it is vital to plan for this and make use of your annual pension allowance (up to £40,000 depending upon personal circumstances).

In addition, you can take advantage of your tax-free ISA annual allowance (£20,000 in 2017/18). One advantage of using this saving method is that you won't need to declare any ISA interest, capital gains or income tax on your tax return. Four ISAs are on the market: **cash, stocks and shares, innovative finance** and the **lifetime ISA**.

Digital accounts

In March 2015, the previous government unveiled plans to 'make tax digital' (its vision for modernising the way you pay tax), although the initiative was one of 72 clauses shelved from Finance Bill 2017.

The measure is set to come into force from April 2020, at which point you will be required to keep digital records and send HMRC quarterly updates if your annual turnover is more than £10,000 a year. However, this is subject to further change.

The theory behind this should make it easier for you to plan your finances. It will mean you will not have to give HMRC information it already has, while also enabling you to see a single picture of your liabilities and entitlements in one place – much like an online bank account.

However, several issues are still up in the air at the time of writing and these could affect the finances of your business. Firstly, the identity of the software that will be compatible with HMRC and how much it will cost to implement is unknown. HMRC previously estimated Making Tax Digital to cost around £280 per business.

Insurance

Whether you're an experienced contractor or new to self-employment, it is wise to set aside a certain amount of cash to cover the costs of your essential insurance premiums. You will not have a death-in-service benefit usually provided by an employer, nor will you be entitled to sick pay or protection against mistakes or damage related to you or your business.

There are various policies to consider, including the aforementioned income protection and critical illness cover in the event you become unwell or unfit for work.

Professional indemnity insurance

Professional indemnity insurance helps protect you in the event of claims from unsatisfied clients. This includes if there is a problem with your work or if you've made any mistakes which cost your client money.

Some firms insist on contractors holding their own professional indemnity insurance before you start work as a client can pursue you for compensation – even if you haven't done anything wrong. This will cover any potential legal costs involved with defending yourself.

Life insurance

One option to contemplate, particularly if you have a partner or children who are financially dependent on you, is taking out a life insurance policy. This will pay out a lump sum to your nearest and dearest, ensuring they avoid being plunged into a financial crisis should you die within a certain timeframe.

Public liability insurance

Public liability insurance covers you against the cost of claims made by members of the public for incidents that occur in connection with your business. It covers compensation costs for personal injuries, loss of property or damage to property and death. It provides cover for incidents that occur on your premises and company-related incidents that take place off site.

Personal insurance

There are a range of personal insurance products worth considering if you're self-employed. Personal possession cover should insure your tools against theft, with the number of tool thefts and van break-ins up 30% in the last year. The average tool theft claim cost tradesmen £1,626 last year – up 40% from the 2015 average.

We can help plan your finances.

Important information

The way in which tax charges (or tax relief, as appropriate) are applied depends upon individual circumstances and may be subject to change in the future. ISA and pensions eligibility depend on personal circumstances.

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