

Contractor guide to income protection based on contract rate alone

[Get life insurance quotation now](#)

Contractors can apply for [income protection policies](#) that provide a level of cover based on their annualised contract rates, and not just on their salary. This is according to [Mark McBurney](#) of [Contractor Financials](#), who have negotiated special contract rate-based policies and mortgages for UK contractors.

"Income protection policies traditionally provided a monthly income based on a percentage of an employee's gross salary if they are unable to work through illness or injury," explains McBurney. "This approach has always worked against [limited company contractors](#), who tend to [take lower salaries](#) for tax-planning purposes that are then bumped up by [dividends](#). This has left many thousands of contractors underinsured and potentially paying for protection that may not pay out in the event of a claim."

McBurney continues: "Whilst certain schemes will protect dividend income, this is far from ideal for most contractors due to the impact of retained profits. However, if the income protection is based on contract rate then the contractor can claim a far higher income if they are unable to work due to illness or injury. And such a gross contract approach is unaffected by the salary or dividend that contractors choose to draw from their limited companies."

Contract rates versus salary

According to McBurney, income protection policies based on annualised contract rates can be of huge benefit to contractors: "Calculating, and proving, an employee's salary and using it to calculate the income from the policy and its premiums is straightforward.

"However, limited company contractors not only have low salaries relative to their total earnings, but their income may also fluctuate on a monthly basis during the course of a year as they change contracts. Basing income and premiums on an annualised contract rate can allow for this."

For example, a contractor earning £30 per hour working 35 hours per week for 52 weeks of the year could earn a gross annualised contract income of £54,600. Based on this ideal annualised sum, a contractor taking out a basic income protection policy could expect to receive £2,275 per month, which is 50% of their annualised contract income, if they are unable to work.

And contractors can opt for higher cover, depending on their personal circumstances, as McBurney explains: "There are income protection policies that will provide incomes of up to £12,500, although of course monthly premiums will increase to reflect the higher cover."

Contractor income protection – how much will it cost?

"Costs can vary depending on the level of cover required, but a typical 36-year-old non-smoking male IT contractor with no medical conditions can cover themselves to age 60 for just £49 per month," McBurney says. "For this monthly premium the contractor would receive an income of £2000 per month if they are unable to work due to illness or injury, and the policy would begin to pay after a three-month deferment." [Figures correct at time of writing].

However, McBurney stresses that every contractor and their personal circumstances are different, and so individuals should consult a financial adviser before making any decisions, particularly as a contractor's circumstances can change over time.

Premiums can vary considerably according to occupation, age, pre-existing medical conditions, family medical history, the policy's length and other factors such as lifestyle. Another important factor is the deferment period – the time a contractor is not working before the policy is activated and they start taking an income from it.

Depending on a contractor's personal circumstances, policies are generally best taken out personally, rather than through the contractor's limited company, to avoid the benefit being subject to income tax under Pay As You Earn (PAYE) when it is claimed. The income paid out by the policy itself is tax-free if the premiums have been paid personally.

Why contractors should consider income protection

"Most employers have policies that provide their employees with long term sick pay to run alongside their statutory sick pay," says McBurney. "As a result, many permanent staff can expect to receive their full pay for extended periods that can be as long as twelve months or more, depending on the employer."

But, McBurney warns, contractors simply don't have this perk of being employed: "If a contractor can't work because of an accident or illness, then they won't get paid. And if they don't have savings, the contractor and their family could rapidly run into financial trouble, possibly losing their home as state benefits just won't cover the costs.

"Sadly some freelancers and contractors take out unsuitable accident, sickness and unemployment cover, which can lead to a false sense of security. These policies will often only pay out for a very limited time, and in many cases are inappropriate for those on short-term contracts, which could leave contractors

“
If a contractor can't work
because of an accident or
illness, then they won't get paid
”

Mark McBurney, Contractor
Financials

dangerously exposed.”

According to McBurney, an income protection policy can maintain a minimum level of income to cover mortgage costs and bills until the contractor recovers, or could provide a vital source of income until retirement if the condition is long term.



Mark McBurney

Protection Team Manager

ContractorFinancials

Mark McBurney is an experienced financial adviser, with ten years' history in the mortgage market, now specialising in protection for contractors.

Contractor Financials specialise in providing financial advice tailored to the needs of contractors and freelancers. [Read Full Profile...](#)

[View all our experts](#)

He points out that more than half of the 2.62 million people in the UK on incapacity benefit have been off work for more than five years. “And in the short-term, nearly 25% of all people aged 35 will at some point during their working life suffer a disability lasting more than three months. So,” McBurney concludes, “an income protection policy should really be viewed by contractors as a ‘must have’, not a ‘nice to have’.”

Published: Tuesday, April 26, 2016

© 2016 All rights reserved. Reproduction in whole or in part without permission is prohibited. Please see our [copyright notice](#).



ABCe verified website - last audit confirmed 134,482 monthly unique visitors

© Copyright 2016 Byte-Vision Limited UK. All rights reserved [Copyright notice](#)