

## Exposed: the 'win-win' that can cost clients less and earn contractors more

Not all contractors are 'created equal'. For clients, there can be huge savings to be made by taking a little time to explore how contractors trade. And contractors can gain considerable competitive advantage by understanding how their own trading vehicle, and those of competitor contractors, impacts on the total costs to clients.

Contractor costs to clients can vary hugely according to trading, IR35 and employment status. Clients and employers can secure much greater value by targeting contractors using less expensive trading options, but who still achieve their target earnings.

In extreme cases, for the same workers with similar skill sets and requiring identical net income (that's income after taxes are paid) but in different circumstances, the gross cost to the client can vary by as much as £60,000.

The results of ContractorCalculator's analysis show that clients and employers could substantially reduce their labour costs by hiring contractors outside IR35. Not only that, but labour costs could also be further reduced by targeting married contractors – although deliberately setting out to hire married contractors is likely to breach equality laws.

To help with budgeting and first stage feasibility studies, contractors and clients/employers can use ContractorCalculator's [online interactive financial and tax calculators](#) to work out their own gross hiring costs and net incomes.

### Gross hiring/employment costs to clients and employers

Contractors and employees often evaluate contract and employment options in terms of the net pay they will receive after taxes. Many workers initiate remuneration negotiations by focusing on a net amount, without any thought about the gross cost to their prospective client or employer.

When generating the cost of hiring/employment, the assumption has been that the contractor or employee has opened the negotiation with the client or employer by saying, "I would like £X,000 per month after taxes".

ContractorCalculator has crunched the numbers. Scenarios representing contractor and employee monthly incomes of £3,000, £5,000 and £7,000, net of taxes but without expenses, have been analysed in the following table to demonstrate the cost to the client and employer. These costs do not include an agency margin.

The five scenarios are:

Contractor outside IR35: Splitting dividends: this represents a contractor limited company with two spouses each taking a small salary and splitting the rest via dividends

Contractor outside IR35: Single: this represents a single shareholder director limited company contractor paying a low salary and the balance as dividends

Contractor inside IR35: this scenario considers a single limited company contractor inside IR35

Umbrella contractor: PAYE: a contractor employed by an umbrella company

Fixed-term employment contractor: an employed contractor paid via the agency Pay As You Earn (PAYE) payroll or via their client's payroll.

First, let's examine the headline figures for future comparison.

Payment method	Monthly net (after taxes) for the contractor		
	£3,000	£5,000	£7,000
	Cost to employer per year (£)		
Contractor outside IR35 : Split dividends	43,079	73,079	106,664
Contractor outside IR35 : Single	43,079	82,211	126,408
Contractor inside IR35	58,845	108,413	165,787
Umbrella contractor: PAYE	56,695	104,060	158,937

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Fixed-term employment contractor	55,901	102,991	157,497
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The above table shows that:

At £3,000 net income levels, limited company contractors outside IR35 are significantly less costly to hire than contractors inside IR35 who are employed by an umbrella or on a fixed-term contract

From £5,000 net income to the worker and above, married limited company contractors are the most cost-effective solution for clients and employers

Umbrella company and fixed-term contract contractors cost clients broadly the same. Umbrella company contractors may benefit from expenses, but they pay fees and employer's NICs out of their income.

A married limited company contractor may therefore be prepared to take a lower rate than any other type of contractor, whilst still achieving the same income. Single contractors caught by IR35 or using an umbrella company have the highest pay requirements to achieve the same net pay.

## The impact of clients forcing contractors onto the payroll

The next table shows how much more the client will pay when the trading payment method changes. The baseline used below is married limited company contractors splitting dividends.

Payment method	Monthly net (after taxes) for the contractor		
	£3,000	£5,000	£7,000
	Increase in cost to employer per year (£)		
Contractor outside IR35 : Split dividends	-	-	-
Contractor outside IR35 : Single	-	9,132	19,744
Contractor inside IR35	15,766	35,334	59,123
Umbrella contractor: PAYE	13,616	30,981	52,273
Fixed-term employment contractor	12,822	29,912	50,833

The above table shows that:

There is little difference in the cost to the client when hiring married and single limited company contractors at lower rates of pay. This changes when pay increases to £5,000 and above, when it becomes more expensive to hire a single contractor

To hire a contractor expecting £3,000 per month net of taxes inside IR35, or employed via an umbrella or agency payroll/client, costs the client significantly more – as much as approximately 35% more

The cost of hiring a single contractor inside IR35 who requires a net income of £7,000 per month is nearly £60,000 more per year than hiring a married limited company contractor outside IR35

Taking a married contractor requiring a net income of £7,000 per month onto the payroll costs the client an additional £50,833.

The latter scenario represents what may be occurring in the public sector as a result of the off-payroll rules. An expectation of £7,000 net each month is not unreasonable for a senior interim.

And demographically, senior interims are more likely to be married and splitting dividends. Therefore each time a public sector client forces a contractor onto its payroll, it costs taxpayers an additional £50,000 per year.

## Analysing day rates

The following table details the cost per day to clients when hiring contractors using the different payment methods. The figures are based on 220 working days per year, and the contractor receives their target net income of £3,000, £5,000 or £7,000 per month. These costs do not include an agency margin.

Payment method	Monthly net (after taxes) for the contractor		
	£3,000	£5,000	£7,000
	Gross day rate paid to contractor (£)		
Contractor outside IR35 : Split dividends	196	332	485
Contractor outside IR35 : Single	196	374	575

Contractor inside IR35	267	493	754
Umbrella contractor: PAYE	258	473	722
Fixed-term employment contractor	254	468	716

As with the annual cost to clients, there is a wide variation in gross day rate costs. At the lower pay rates outside IR35, there is little difference in costs to clients until IR35 or employment kicks in, when costs increase sharply, by as much as 36%.

When contractor net pay expectations hit £5,000 and above, the gaps between different trading vehicles and payment methods widen, and it becomes progressively more expensive for clients to hire contractors inside IR35 or employed.

The following table shows how the increase in day rates and net income expectations increases as the payment method changes. The baseline is married limited company contractors taking dual salaries and splitting dividends.

Payment method	Monthly net (after taxes) for the contractor		
	£3,000	£5,000	£7,000
Contractor outside IR35 : Split dividends	-	-	-
Contractor outside IR35 : Single	-	42	90
Contractor inside IR35	72	161	269
Umbrella contractor: PAYE	62	141	238
Fixed-term employment contractor	58	136	231

These figures highlight that:

There is little difference between married and unmarried limited company contractors outside IR35 with lower net income expectations

It can cost a client an additional £269 per day to hire a senior contractor inside IR35, versus a married contractor outside IR35

To take a married limited company contractor onto the payroll costs clients an additional £231 per day

Overall, it appears that with an understanding of contractors' business and personal circumstances, and a willingness to be flexible, clients could save considerable amounts of money from their labour costs.

Contractors broadly comparable by skill set could become highly differentiated as a result of their marital status, trading vehicle, IR35 status and employment status.

ContractorCalculator's analysis also highlights that government initiatives, such as the off-payroll rules, where contractors are taken onto their public sector client's payroll and so pay tax via PAYE, cost the taxpayer significantly more.

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