

Financial issues for first time contractors

Introduction

Moving from permanent employment to a contracting career has immediate and long term financial issues to consider: What contract rate will ensure equivalent or more net earnings as before? What rate can be charged? What are the impacts of **IR35**? How much do you need to cover existing benefits? How can you maximise your earnings?

Minimum Starting Contract Rate

Contractors typically earn more than their counterparts in permanent employment. Our [Permanent to Contracting Calculator](#) shows someone earning £25,000 per annum requires a minimum contract rate of at least £15 per hour (£19 per hour inside IR35) to earn the same via contracting. Other equivalent rates are shown below.

Salary	Hourly rate	
	Outside IR35	Inside IR35
£25,000	£15	£19
£30,000	£17	£23
£35,000	£21	£26
£40,000	£23	£30
£45,000	£25	£35
£50,000	£27	£39

Effects of IR35

IR35 is a piece of tax legislation that came into force in April 2000. It means some contractors are treated for tax purposes as employees and pay significantly more tax. IR35 status, inside or outside, depends on each contract rather than the individual.

Our [IR35 Calculator](#) shows that operating inside IR35 is very expensive. For example, a contractor earning £30 per hour inside IR35 will take home around £730 less each month than a contractor outside IR35. Furthermore, for the contractor inside IR35 to earn the same as a contractor outside IR35, they would need a rise to £40 per hour.

Contract terms are negotiable and contractors are advised to primarily focus their negotiations on remaining outside IR35 rather than earning a few extra pounds in rate. See also '[Financial Impact of IR35 on Contractors.](#)'

Sickness, Holidays & Benefits

When calculating a minimum rate sickness and holidays should be considered together with other employee benefits that are no longer applicable to contractors. A contractor typically works between 44 and 46 weeks per year. Other employee benefits like medical cover, health insurance, etc can be catered for by an extra £3 per hour to cover premiums. See also '[Taking Holidays and Time Off.](#)'

Determining an Initial Rate

Asking friends and associates in the industry can often be the best guide to establishing an initial rate. Asking agents for advice can be useful but bear in mind that their job is to buy the goods (i.e. you) at the lowest possible price and charge them on at a higher margin to their client. See also '[Determining the Contract Rate for Your Skills When Entering the Contract Market.](#)'

Using Agents

Agents are a cost effective method of outsourcing sales activities to secure contracts. Attempting to bypass agents and contract directly will not necessarily secure better earnings. Not only could there be more downtime between contracts, cutting out agents does not necessarily mean earning a higher rate since the client will expect to save due to the direct route they have also taken. See also '[Advantages of Using Agents to Secure Contracts.](#)'

Agency margins vary dependant on contractors negotiation skills and average around 15%. For a contractor earning £30 per hour, a 15% margin over one year is approximately covered by the first 7 weeks work. With a direct route perhaps an extra £2.50 per hour (half the margin) could be charged - but the contract would need to be found within four weeks to earn more over the next year, compared to having no downtime and taking an immediate contract via an agency for the same rate. Securing a direct contract in 4 weeks will be tough unless you have good sales experience or a large network of contacts.

Renewing Contracts

After starting a contract, the next opportunity for increasing earnings is contract renewal time. Judging the bargaining position and negotiating well is key. Our Contract Financial Profile Calculator shows that for a contractor earning £30 per hour, each rise of £1 per hour will result in extra take home pay of £83 per month (outside IR35) or £68 per month (inside IR35). See also '[Preparing and Negotiating a Contract Renewal.](#)'

IR35 Negotiations

For contractors inside IR35 on £30 per hour, negotiating new terms to be outside IR35 results in an extra £730 per month take home pay, equivalent to a £10 per hour rise. Suffice to say, the first stage of negotiations for contractors caught by IR35 should be to try and negotiate more favourable terms.

Our IR35 Calculator shows that if a contractor left an existing client to search for a new contract outside IR35 for the same rate, they could take 11 weeks before securing one and still earn the same as if they renewed the existing contract. Downtime between contracts is normally costly, except in the situation when moving to a new client with a more favourable IR35 position. See also '[Negotiating Your Contract for IR35 Compliance.](#)'

Maximising Earnings - In Summary

The most important aspect to maximise your earnings as a contractor is to learn effective sales and negotiation techniques to avoid selling yourself short on rate. Next, is to remain outside the IR35 legislation which can destroy your net earnings. Once the financials are working, staying in a good position can be done by continually keeping skills updated to remain in demand for the long term.

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