

## Off-Payroll audit guide: How to calculate and budget for the real cost of Off-Payroll



Having evaluated their contingent workforce for IR35 risk, contractor clients should have a solid grasp of who is likely to be considered caught by the Off-Payroll rules, and who should be found outside.

Understanding the financial implications of the Off-Payroll rules, however, is a far trickier task. Accommodating the cost of employment taxes for each contractor deemed 'inside IR35' is just one of numerous factors clients and their recruitment partners must consider.

Identifying and planning for these factors, as well as exploring compliant ways to mitigate their cost, are all essential requirements for effective navigation of the Off-Payroll rules.

### Who's really responsible for employment taxes?

Engaging a legitimately 'outside IR35' contractor makes no material difference to a client and their recruitment partner under the Off-Payroll rules, compared with the original IR35 regime. Unfortunately, the same can't be said where the contractor is caught by IR35, thanks in large part to the employment tax liability.

Under the original IR35 legislation, a contractor would have to work out the 'deemed payment'. This calculation treats the contracting income as the gross cost of hire to the 'deemed employer', deducting proportionate amounts for income tax and both employee's and employer's National Insurance (NI).

However, under the Off-Payroll rules, the 'fee-payer' is deemed liable for employment taxes, which crucially need to be paid *on top* of the sums paid to the contractor. According to the legislation, the fee-payer is the party which deals directly with the contractor or their limited company, which will typically be a recruitment agency unless the client engages the contractor directly.

However, agencies simply cannot afford to fund these costs, which realistically will need to be sourced from the end-client. So, the first calculation will need to be carried out by recruitment partners to determine the new margins they will need to negotiate with end-clients to accommodate the employment tax liability.

### The employment taxes cost of an 'inside IR35' contractor

The employment tax liability consists of employer's NI (13.8%) and the Apprenticeship Levy (0.5%). However, due to certain allowances, most clients and recruiters will find that, rather than 14.3%, the cost of employment taxes amounts to roughly an extra 12-13% of the contract rate, paid on top of the sum paid to the contractor.

## 'Outside IR35' contractor

Let's take the example of a contractor earning £400 per day, working 230 days over the course of a 12-month contract. Operating outside of IR35, that contractor can secure £64,994 in take-home pay, having paid £27,004 of their £92,000 annual contracting earnings in tax. For the client and agency, there are no employment costs to consider.

## 'Inside IR35' contractor (Traditional IR35 rules)

Operating inside IR35 under the original IR35 regime, having calculated the deemed payment, the same contractor would pay £33,759 to the taxman, retaining £58,241 for themselves. The client and agency again have no employment costs to worry about.

## 'Inside IR35' contractor (Off-Payroll rules)

Under the Off-Payroll rules, the same contractor only has to part with £30,106 in personal tax. However, HMRC's accumulative tax take is far greater because it also requires £11,965 in employment taxes from the fee-payer, paid *on top* of the contract rate.

In this instance, the cost of employment taxes is marginally higher than 13% of the contract rate. By inputting a contractor's daily or hourly rate into [ContractorCalculator's free Off-Payroll tax calculator](#), you can obtain a tax summary detailing the impact of the Off-Payroll rules, including the employment tax liability accompanying an 'inside IR35' assessment.

## Calculating the true cost of rate renegotiations

Whereas recruitment partners have a relatively straightforward calculation to make, the behavioural impact of the Off-Payroll rules will be far more difficult for clients to quantify. Budgets will need to be reevaluated, and both client and contractor will likely want to renegotiate rates, with very different outcomes in mind.

Revisiting our earlier example, if our £400/day 'outside IR35' contractor was deemed 'inside IR35' by the client under the Off-Payroll rules, the contractor would require a daily rate of £501 to retain the same amount of post-tax income. Meanwhile, in order to maintain the same cost of hiring post-tax, the client would want to reduce the agreed rate to £354.

The difference between these two evaluations is £147, and things don't get any easier where travel is concerned. The Off-Payroll rules prevent affected contractors from claiming travel and accommodation expenses. As a result, a contractor who might have spent £20,000 on such costs in a year while outside of IR35 may demand as much as a 40% increase in their rate to accommodate this cost under Off-Payroll.

Not every renegotiation will be so drastic, and not all contractors will disagree if deemed caught by IR35. However, you are advised to consider the likely outcome of rate renegotiations, and specifically:

- Which contractors are likely to leave?
- Who can you afford to lose and who is indispensable?
- Which projects may require re-budgeting or cancelling altogether?

Finding answers would usually involve sifting through a lot of information. However, this task is made a lot simpler with IR35 Shield's financial reporting feature.

Having saved the information from each status assessment, IR35 Shield's financial reporting feature uses contractor day-rates, expenses and other financial information to provide a clear overview of the impact of your current contract engagements on your organisation's bottom line. This is shown in the format of a number of different financial reports, each calculating and displaying tax costs, risks and potential savings in granular detail.

This feature also provides forecasts for 'what if' scenarios, generating a visual representation of the financial impact of a proposed change on your firm's financial position. All of this helps to inform an effective financial plan. For more information, visit [IR35Shield.co.uk](https://www.ir35shield.co.uk).

Alternatively, for more comprehensive guidance on navigating the cost of the Off-Payroll rules, and further compliance advice, book a [Shield Passport Process \(SPP\)](#) workshop. This four-stage, 12-step compliance process has been developed by industry experts IR35 Shield and Professional Passport. It's open to recruitment partners and their clients who, over the course of three hours, can learn a structured, compliant approach which effectively mitigates workload and costs created by the Off-Payroll rules.

Published: 15 November 2019

© 2019 All rights reserved. *Reproduction in whole or in part without permission is prohibited. Please see our [copyright notice](#).*

*200,000+ monthly unique visitors*

© Copyright 2019 Byte-Vision Limited UK. All rights reserved [Copyright notice](#)