
THE COST OF EMPLOYING SOMEONE

Understanding the employer / employee relationship

INTRODUCTION

When a worker is hired, they will normally be hired because a calculation has been done. "I need XXXXX doing and if it's done it will be worth £yyyy to me for this work to be done.

A business can get XXXX done for a lot less than £yyyy it will make a profit. And if it gets done for a lot less than £yyyy, it will make a lot of profit.

It could be in the interest of workers if they were to stop measuring themselves by their salary figure and started working out what the value of £yyyy really is. Because employers use employment status as a way of bargaining down the cost to them of engaging someone.

And sometimes, the tax authorities lose out when this decision is made to.

UNDERSTANDING A £24,000 SALARY FIGURE

SCENARIO ONE: A PAYE EMPLOYEE

Assume a salary of £24,000 and a 3% employer pension contribution (£720) and a personal pension contribution of 5% (£1,200 – or £100pcm). This worker will pay...

- £2046 in income tax
- £1,732 in National Insurance
- £1200 in pension contributions (which qualifies for a tax rebate of £240)

Leaving a take-home pay of £19,022

This is before we consider important employer costs. We'll assume that holiday pay is included (no additional holiday above statutory entitlement), and no...

- 'tools of the trade' costs
- office costs
- payroll costs
- Maternity / Paternity leave costs (two thirds of UK business now provide enhanced maternity leave terms) – my calculations are leaving this blank even though it obviously is a liability.
- Sick Leave (assuming it is paid 100%, this isn't a new cost to a business, but it is a liability when putting value on a worker)
- Jury Service
- redundancy liability
- unfair dismissal liability
- training costs (we can quantify the actual cost of the training but there's also the 'lost time' factor here)
- sick days (UK average 5.8)
- 'wasted unproductive time' (i.e. things that can be improved by good – costly - management)

When we compare with a payroll company, we'll assume that there is an Umbrella payroll company that charges £500 a year

This worker will cost the **employer** the following

Wages (before deductions)	£24,000
Employer's Class A NICs	£2,099.81
Pension	£720
Additional Employer NICs on pension (P11D)	£99.36
Apprentice Levy (for larger employers)	£120
Total payroll cost to the employer	£27,039.17

A true cost of someone earning £24,000 a year with the minimum 3% auto-enrolled pension contribution with the following notional costs...

- £3750 in office rental and other establishment costs
- £1,200 a year for PC, tech support and phone
- £800 a year training
- £300 consumables (paper, toner, tea coffee, toilet roll, etc)
- £1,500 for admin overheads (payroll, secretarial, appraisals, etc)
- £200 to cover the cost of jury service
- £1,000 liability for redundancy
- £500 liability for unfair dismissal claims
- 5.8 days lost to illness and a few days 'lost' to training.

According to the Accounting Services for Business 'true cost of an employee' calculator¹, someone on £24,000 really costs about £45,216 to employ – assuming NO redundancy (so 1.88 x the salary cost). This figure assumes that – of the 261 days an employee is working, 64.15 are 'unproductive' – i.e. time spent not doing useful work (and there is no question that freelancers will have some time like this, but probably not as much when incentives are borne in mind).

So, with important qualifications, this is a useful comparator for someone who is a freelancer, thereby avoiding most of these notional costs. Even if we think it overestimates wildly (e.g twice as much as it should – and that would also be very conservative) we still have an employer cost of £10,000 on top of the £24,000 salary costs.

SCENARIO TWO – A SELF-EMPLOYED SOLE TRADER

Before we get into tax / pension / NIC costs, we should note that a huge saving (£10,000 - £20,000 on the scenario above) is being made already. Employers often have very good reasons to want those costs (loyalty, staff development, contingency planning etc) but they are costs. And they are costs that can be avoided by hiring a freelancer.

In this scenario, we have a Self-Employed Sole Trader who is earning an average of £24,000 in profits (after legitimate business expense have been deducted).

They will have to make their own pension contribution – 5% (like an employee would) – so £1200 per year. They will pay ...

- £2,300 income tax
- £1,463.60 in NICs
- 1,200 in pension contributions

Take home pay = £19,036.40

HMRC will contribute £300 as a tax rebate to your pension.

¹ <https://www.accountingservicesforbusiness.co.uk/calculators1/true-cost-of-an-employee>

This figure is not perfect when comparing employees and sole traders because it assumes no re-claimable costs. In reality, we could possibly do a comparison where the sole trader is billing the client £25,500 and claiming £1,500 in legitimate expenses. But let's keep it simple and assume we're comparing a £24k salary with a £24k-profit sole trader.

SUMMARY – EMPLOYEE COSTS V COST OF HIRING A SOLE TRADER

Someone who understands their salary (as an employee) or profits (as a sole trader) to be £24,000 will take home approximately £19,000 but the employee will have a slightly better pension situation (they will get the 3% contribution from the employer).

For the employer, assuming absolutely no other liabilities that the employee brings to the employer, this will cost the employer a further £3,039.17 in employer NICs, pension contributions.

But then an employer has to finance an employee – office costs, training and other liabilities that will cost them another £10,000 on top in 'conservative' circumstances, or £20,000 or more on top in some circumstances, depending on how they account for the employee as a liability.

So hiring a freelancer offers engagers huge savings already. For someone who describes themselves as having a salary of £24,000, they will cost at least £13k by this rough reckoning.

Freelancers don't come with these costs. They are in a weaker bargaining position and in some cases employers will get more value £ for £ from freelancers (though this is often a short-termist view as employers also get lots of benefits from a loyal workforce).

NOW WHAT ABOUT 'UMBRELLA' PAYROLL COMPANIES?

Now imagine a freelancer who is earning £24,000 as a sole trader is pushed into trading through a payroll company because of an engagers IR35-related jitters.

This worker will now generate

- Employer NICs
- A payroll admin cost (I've seen an example of £500 pa)
- Employer pension contribution
- Additional employer NIC on pension (P11D)
- Possibly an apprentice levy

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Will the engager increase the £24,000 figure to £27,039.17? If not, this is going to be a pay-cut.

But – either way – these three scenarios show how big a deal employment status is for an employer who is making a utilitarian calculation about using your services.

The big factor that isn't on the table here is the one that unions care about the most – security and your ability to bargain with the employer as an equal. Only employees will get things like parental rights, higher job security, or career development. Workers have more bargaining power as an employee of an employer – and they probably have none as someone who is paid through a payroll company.