

## Employee or Independent Contractor – What are the costs?

Do you work as an independent contractor? As an employee? If you're paid on an hourly basis at the same rate, you'll get a bigger weekly paycheck as an independent contractor. But what are your costs, and what difference does it make to your net income over the course of a year? Here are numbers for 3 individuals: someone who works exclusively as an independent contractor, a full-time employee, and a freelancer who earns some income as an independent contractor and some as a part time employee, perhaps at multiple employers. Some costs will be the same for all 3 individuals, others will vary by work classification.

The spreadsheet is organized similarly to a tax return and is based on the new tax law. Each person earns \$50,000 per year. The independent contractor's expenses include liability insurance to replace a protection that comes automatically with being an employee, even though some people who work as independent contractors go without it. The full time employee paid part of the cost of employer-provided group health care. Other items may apply to both but are deductible on taxes for only one. Some (groceries, rent) don't get included on an actual tax return, but we've listed them because you do pay them and they do reduce your available money for the year.

Note that we aren't considering the question of employee classification. Do you have an actual contract, or is the employer simply sending you a Form 1099 at the end of the year? Should you be classified – and get paid – as an employee for some jobs that you're treated as a contractor? That's all a topic for another article. [PROVIDE REFERENCE IF ARTICLE IS IN THIS OR A PREVIOUS NEWSLETTER]

As you can see, a higher paycheck as an independent contractor with no taxes taken out doesn't always translate into more disposable income at the end of the year.

### Ray and Paul

<i>**Assumptions: Income is solely through work, all work is performed in Minnesota, individual is unmarried with no dependents</i>					
<i>Vehicle is driven 10,000 in year, C. Rodent puts 5000 business miles on vehicle, B. Demon puts 2500 business miles on vehicle</i>					
<i>Food expense at \$400 / month, independent contractor can deduct half of business meals / entertainment on Schedule C</i>					
Employee Name	Catnip Contender Rodent	Felipe Motley Mule			Bic Demon
Employee OR Independent contractor?	Independent Contractor	Fulltime Employee			Employee & Independent contractor
Tax form received from employer/client	<b>1099</b>	<b>W-2</b>		<b>W-2 Portion</b>	<b>1099 Portion</b>
<b>Gross Income</b>	\$50,000.00	\$50,000.00		\$25,000.00	\$25,000.00
Less Expenses:					
Automobile fuel	\$1,120.00	\$1,120.00			\$1,120.00
Automotive maintenance/repairs	\$1,000.00	\$1,000.00			\$1,000.00
Cost of food (groceries, restaurants, etc.)	\$4,800.00	\$4,800.00			\$4,800.00
Health Insurance (self-procured)	\$3,330.00				\$3,330.00
Health Insurance (through employer) *		\$960.00			
General Liability Insurance	\$800.00				\$800.00

Professional Liability Insurance	\$1,200.00				\$1,200.00
Tool purchases for work	\$200.00				\$100.00
Office expenses	\$500.00				\$250.00
Rent/Property taxes/home insurance (cost of housing)	\$12,000.00	\$12,000.00			\$12,000.00
<b>Income after 'typical' life expenses</b>	<b>\$25,050.00</b>	<b>\$30,120.00</b>		Bic Demon total:	<b>\$25,400.00</b>
Reductions in taxable income (1040 Sch. C)	\$6,100.00				\$4,300.00
Professional Liability Insurance	\$1,200.00	\$0.00			\$1,200.00
General Liability Insurance	\$800.00	\$0.00			\$800.00
Vehicle expenses (standard mileage) §	\$2,700.00	\$0.00			\$1,350.00
Office expenses	\$500.00	\$0.00			\$250.00
Tools and equipment repairs	\$200.00	\$0.00			\$100.00
Professional services (tax prep, lawyer, etc.)	\$250.00	\$150.00			\$250.00
Deductible meal/entertainment portion	\$200.00	\$0.00			\$100.00
Business use of home (50 sq. ft) ¶	\$250.00	\$0.00			\$250.00
<b>Schedule C profit/loss</b>	<b>\$43,900.00</b>				<b>\$20,700.00</b>
Deductible part of self-employment tax	\$3,101.44				\$1,420.00
Health insurance cost for self-employed	\$3,330.00				\$3,330.00
Standard Tax Deduction (2018)	\$12,000.00	\$12,000.00			\$12,000.00
<b>Net taxable income</b>	<b>\$25,468.56</b>	<b>\$38,000.00</b>		Bic Demon total:	<b>\$28,950.00</b>
Federal Income Tax	\$2,865.73	\$4,369.50			\$3,283.50
State Income Tax	\$1,363.54	\$2,247.01			\$1,608.98
FICA Tax (Social Security, Medicare) paid by employee ‡		\$2,907.00		\$1,912.50	
Self Employment Tax †	\$6,202.87				\$2,924.82
<b>Total Tax</b>	<b>\$10,432.14</b>	<b>\$9,523.51</b>		Bic Demon total:	<b>\$9,729.80</b>
Income after 'typical' life expenses	25,050.00	30,120.00			25,400.00
Total Taxes (Income/SE/FICA) Owed	10,432.14	9,523.51			9,729.80
<b>Available money after 'typical' life expenses/taxes</b>	<b>14,617.86</b>	<b>20,596.50</b>			<b>15,670.20</b>

Footnotes to the spreadsheet, referenced to line number (replace by \*, ‡, §, etc in newsletter):

\* Employee health insurance isn't deductible on your taxes except in the rare case where your employer doesn't treat it as a pre-tax deduction from your wages. It's nonetheless an expense and parallels individual health insurance for a contractor.

§: Mileage to work is a cost for an employee as well as a contractor, but it's listed only for contractors because only contractors get a tax

¶: Business use of a home applies only to a space (not necessarily a separate room) that is used exclusively for business purposes. The deduction is based on pro-rated square footage, not the amount of time or income you

generate. The deduction may be available if you're an employee who works from home, but there are more restrictive rules, less deductibility, and don't usually apply to entertainment technicians.

±: The independent contractor pays the full cost on a tax return, though it also becomes a partly-deductible expense. The employee pays half the cost through withholding directly on the paycheck. The employer pays the other half, one of several ways in which hiring an employee is more expensive for the employer.

Not included: Retirement isn't included because it's so inconsistent, due to both company policies and individual choices. For example, some employers match part of an employee's contributions to a 401(k) or 403(b), effectively increasing your income if not your take-home pay,, but not all employers employers match or even have a plan. If you're an employee, even if you're part time, you may be able to contribute if you want to, and your employer has to allow it if you work over 1000 hours per year. Anyone can set up an IRA (Roth or regular), whether or not there's an employer option, and contractors have additional possibilities. The amount that people set aside, whether contractors or employees, is highly variable.