



## Career Decisions

### **Gardner Resources Consulting: Independent Sub-Contractor VS. W-2 Employee**

You can be paid in two ways: as an incorporated independent sub-contractor or as a W-2 employee. These two terms explain your relationship with Gardner; they also come with significant tax differences.

Big picture, independent sub-contractors are not permanent employees. They work for nobody but themselves, and have no taxes withheld from their paychecks. You are doing business directly with the company that is paying you just as a vendor or supplier would. W-2 employees are usually considered permanent employees and have social security and certain taxes withheld from their paychecks.

Because W-2 employees have social security and taxes withheld, they often only have to be concerned with filing their taxes every year before April 15th. Independent sub-contractors, often have certain tax liabilities each quarter. Because nothing is being withheld from your check, the government will most likely want you to pay estimated taxes on your income each quarter.

When working as a W-2 employee through a firm like Gardner, we have the direct relationship with the employer. We, in turn, reach out to you to provide the actual services, pay you, and provide other services such as health insurance and retirement benefits. We pay you as an employee of Gardner. We report your earnings to the IRS on a form W-2, pay you per your contract, withhold federal and state income tax, and pay our share of your social security tax. We are held to all federal and state employment laws when employing you. You are not an employee or contractor of our client, even though you work within their facility.

When working as an independent sub-contractor through Gardner, you must be incorporated. We retain the direct relationship with the employer as many larger firms will only work with companies like ours and not with individuals. As you provide the actual services, we pay you, as we would pay any vendor or supplier. You are employed by no one but yourself, and while you may work at our client's site, you have no direct business relationship with our client.



Typical advantages of incorporated independent sub-contractor status:

- Personal freedom – you are employed by yourself
- No taxes withheld from your pay check – although you are still responsible for payment of all taxes and may face a larger tax burden because the employer does not contribute

Typical advantages of W-2 employment status:

- Predictable regular pay checks
- Taxes withheld from your paycheck with your employer contributing a proportion typically means no need to file estimated taxes
- Eligibility, in most cases, for employee benefits such as health care and 401k retirement savings account

The best way to determine the specifics around independent sub-contractor versus a W-2 relationship is go to the source, the Internal Revenue Service. The IRS has an Independent Contractor Test which is explained below.

### **IRS Independent Contractor Test**

The IRS formerly used what has become known as the "Twenty Factor" test. Under pressure from Congress and from representatives of labor and business, it has recently attempted to simplify and refine the test, consolidating the twenty factors into eleven main tests, and organizing them into three main groups: behavioral control, financial control, and the type of relationship of the parties. Those factors appear below, along with comments regarding each one (source: IRS Publication 15-A, 2006 Edition, page 6; available for downloading from <http://www.irs.gov/pub/irs-pdf/p15a.pdf>).

#### **Behavioral control**

Facts that show whether the business has a right to direct and control how the worker does the task for which the worker is hired include the type and degree of –

- *Instructions the business gives the worker.* An employee is generally subject to the business' instructions about when, where, and how to work. All of the following are examples of types of instructions about how to do work:
  - *When and where to do the work*
  - *What tools or equipment to use*
  - *What workers to hire or to assist with the work*
  - *Where to purchase supplies and services*
  - *What work must be performed by a specified individual*
  - *What order or sequence to follow*



*The amount of instruction needed varies among different jobs. Even if no instructions are given, sufficient behavioral control may exist if the employer has the right to control how the work results are achieved. A business may lack the knowledge to instruct some highly specialized professionals; in other cases, the task may require little or no instruction. The key consideration is whether the business has retained the right to control the details of a worker's performance or instead has given up that right.*

- *Training the business gives the worker.* An employee may be trained to perform services in a particular manner. Independent contractors ordinarily use their own methods.

## Financial control

Facts that show whether the business has a right to control the business aspects of the worker's job include:

- *The extent to which the worker has unreimbursed business expenses.* Independent contractors are more likely to have unreimbursed expenses than are employees. Fixed ongoing costs that are incurred regardless of whether work is currently being performed are especially important. However, employees may also incur unreimbursed expenses in connection with the services they perform for their business.
- *The extent of the worker's investment.* An employee usually has no investment in the work other than his or her own time. An independent contractor often has a significant investment in the facilities he or she uses in performing services for someone else. However, a significant investment is not necessary for independent contractor status.
- *The extent to which the worker makes services available to the relevant market.* An independent contractor is generally free to seek out business opportunities. Independent contractors often advertise, maintain a visible business location, and are available to work in the relevant market.
- *How the business pays the worker.* An employee is generally guaranteed a regular wage amount for an hourly, weekly, or other period of time. This usually indicates that a worker is an employee, even when the wage or salary is supplemented by a commission. An independent contractor is usually paid by a flat fee for the job. However, it is common in some professions, such as law, to pay independent contractors hourly.
- *The extent to which the worker can realize a profit or loss.* Since an employer usually provides employees a workplace, tools, materials, equipment, and supplies needed for the work, and generally pays the costs of doing business, employees do not have an opportunity to make a profit or loss. An independent contractor can make a profit or loss.



## Type of relationship

Facts that show the parties' type of relationship include:

- *Written contracts describing the relationship the parties intended to create.* This is probably the least important of the criteria, since what really matters is the nature of the underlying work relationship, not what the parties choose to call it. However, in close cases, the written contract can make a difference.
- *Whether the business provides the worker with employee-type benefits, such as insurance, a pension plan, vacation pay, or sick pay.* The power to grant benefits carries with it the power to take them away, which is a power generally exercised by employers over employees. A true independent contractor will finance his or her own benefits out of the overall profits of the enterprise.
- *The permanency of the relationship.* If the company engages a worker with the expectation that the relationship will continue indefinitely, rather than for a specific project or period, this is generally considered evidence that the intent was to create an employer-employee relationship.
- *The extent to which services performed by the worker are a key aspect of the regular business of the company.* If a worker provides services that are a key aspect of the company's regular business activity, it is more likely that the company will have the right to direct and control his or her activities. For example, if a law firm hires an attorney, it is likely that it will present the attorney's work as its own and would have the right to control or direct that work. This would indicate an employer-employee relationship.

Do not underestimate the difficulty of applying these standards to specific individuals performing services. In doubtful cases, always consult a knowledgeable labor and employment law attorney.