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Do You Want A 1099 Or A W-2?

Asked another way, “independent contractor or employee?” It seems like such a simple question. As we approach year-end, companies and workers everywhere may not think about it but they should.

If you’re an employee, taxes have to be taken out. That means you’ll receive an [IRS Form W-2](#) in January. In contrast, if you’re an independent contractor, you’ll get full pay with no deductions. Of course, you are liable for your own taxes. Come January, assuming your total pay was \$600 or more, you’ll receive an [IRS Form 1099](#).

But is it that simple? What if you’re the employer not the recipient? This is one of the more momentous decisions in the tax world. In fact, it goes well beyond taxes and covers workers’ compensation, unemployment insurance, state and federal wage and hour laws, pension laws, nondiscrimination laws and more.

It’s hard to think of a more pivotal issue. Yet this decision is made thousands of times a day all over America. Sometimes it is done without much thought. Some employers ask “1099 or W-2?” as if they were asking how you take your coffee.

If you’re the worker, you may be tempted to say “1099,” figuring you’ll get a bigger check that way. You will in the short run, but you’ll actually owe



(Photo credit: Wikipedia)

higher taxes. As an independent contractor, you not only owe income tax, but self-employment tax too. On the first \$113,700 of income, that's a whopping 15.3% rate. Beyond \$113,700, the rate drops to 2.9%.

In contrast, if you're an employee, you pay only one-half the Social Security tax (your half is 7.65%) on wages up to \$113,700, plus one-half the Medicare rate (your half is 1.45%) on all wages. See [IRS Publication 225](#). Your employer pays the same. If you have income over \$200,000, you're subject to an additional 0.9% Medicare tax withholding on all your wages. The additional Medicare tax [does not apply to employers](#).

This is an even more striking comparison in 2014. The Social Security wage base is expected to increase from \$113,700 for 2013 to \$117,000 for 2014. That's not the only thing to keep in mind, of course, but it does suggest that it can be shortsighted to turn down employee status. Apart from tax law, employee status carries a host of nondiscrimination laws, pension and benefits laws and wage and hour protections that apply to employees but not to independent contractors.

For all of these reasons, employers have big incentives to use independent contractors. Often this can be done within the confines of the law in ways that are perfectly proper. Yet some employers push the envelope to treat workers as independent contractors who are clearly employees if anyone bothers to look.

That's where the IRS and many other agencies come in. They can ferret out the truth according to various legal standards that often boil down to how much control the company has over the worker. See [Some Control Won't Convert Independent Contractors To Employees](#). The IRS has much to say on this, including [Employee v. Independent Contractor—Seven Tips For Business Owners](#).

The area is heating up in a big way, with many believing that inappropriate worker status determinations are a major tax loophole. If you're an employer, be careful.

You can reach me at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.