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If 30% Of Pay Is Benefits, What About Independent Contractors?

Compensation experts say most people get much of their pay in benefits. Figures vary materially, but benefits in some cases can amount to a whopping 30% of pay. Put differently, employers may fund another 30% in benefits on top of the salary listed on your Form W-2. See [Why Most Employees Make Up to 30% Less Than They Should — Is It Happening to You?](#)

The tax law encourages companies to provide benefits that are tax deductible by the company but don't increase the tax bite on employees. Understandably, employees like this. In fact, experts say (as we should know intuitively) that an employer may be able to provide a smaller amount in non-taxable benefits than in taxable pay. In effect, the employer shares the tax benefit, a kind of tax arbitrage.

If you're an employee, you receive a net check on which taxes are withheld. You receive an [IRS Form W-2](#) from your employer in January the following year. If you're an independent contractor, you'll get full pay with no deductions, but are liable for your own taxes. Come January, you'll receive an [IRS Form 1099](#).



Suppose an employer offers a worker a \$100 raise. Since wages are subject to income and payroll taxes, let's say the employee takes home \$60. If the employer instead gives the worker \$70 of non-taxable benefits, the employee is \$10 better off. The employee should be happier and more loyal.

The employer is better off too since it spent \$70 instead of \$100. How, then does this fact pattern relate to independent contractors? It doesn't. Independent contractors are paid gross pay with no tax withholding.

That means they handle their own taxes and provide their **own** benefits. Want to compare the total paid to an employee with the total paid to an independent contractor? The total paid to the employee really should include the cost of benefits.

Suppose that a company pays \$50 in direct pay to an employee or \$50 to an independent contractor. Which is cheaper? Clearly the latter. If you assume the cost of benefits for the employee is 30% (\$15), then the comparison is \$65 to \$50, not \$50/\$50.

What happens if an independent contractor is paid \$50, but is told he is being **reclassified** as an employee? The reclassification may be because the company decides it's best, because of a private or government lawsuit or because of an audit. The audit may be conducted by the IRS, a state tax or labor authority, or a worker's compensation or unemployment insurance agency.

It could be all of the above, for one dispute over the status of a worker usually leads to another. It can be a line of state and federal agencies with their hands out. See [Independent Contractor Or Employee: Why It Matters](#). Such transitions can be difficult to manage, with expectations difficult to meet on both sides. If the worker is provided benefits, their cost must be factored in, as should taxes and administrative costs.

This seems obvious, but the pressures on employers, workers and the system are not. The IRS and others are gearing up this area. Even the [IRS Inspector urges crackdown on mislabeling 'independent contractors'](#).

And don't forget the threat of the workers themselves. A worker who signs a contract agreeing that he is an independent contractor can sue claiming he is actually an employee. He can sue just for himself or on behalf of a class of workers. Employers often think the law doesn't allow such reversals but it

does. And that can mean paying benefits, even though the worker signed a contract to the contrary. See [Independent Contractor or Employee? The Multiple Issues](#).

There's no easy answer to this swirling mix of liabilities and risks. But a periodic check-up of the independent contractor contract is a good idea. See [Ten Tips for Drafting Independent Contractor Agreements](#). So is a periodic review of how workers are treated in actual practice, including what they are told about how much independence they have.

Bottom line? Be careful out there.

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.