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## **Benefits of Compensating Independent Contractors vs. Employees**

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Due to federal law, and motivational factors, there are many differences in the way employees are compensated compared to independent contractors. Independent contractors may call themselves by a variety of names such as freelancers, consultants, the self-employed, entrepreneurs, or business owners, although it makes no difference in the eyes of the law. Independent contractors are people who contract to perform services for others but do not have the legal status of employees. Libraries can save time, money, and headaches by hiring independent contractors instead of employees as long as the independent contractors are correctly classified.

One benefit when using an independent contractor is saving money in payroll and benefit expenses. Libraries do not have to pay many of the taxes and mandated benefits for independent contractors like they are required to do for employees. Libraries usually must pay employee expenses such as:

- federal payroll taxes, including a 7.65% Social Security tax and a usually small (.08%) federal unemployment insurance tax
- state unemployment insurance premiums
- workers' compensation insurance premiums
- employee benefits, such as health insurance, paid vacations, sick leave, retirement benefits and life or disability insurance, and
- office space and equipment.

These expenses add at least 25% to 30% to payroll costs. For example, if you pay an employee \$10 per hour, you will probably pay another \$2.50 to \$3 per hour (or more) in employee expenses. None of these expenses are incurred when hiring an independent contractor. Therefore, even though independent contractors are often paid more per hour than employees doing the same work, they still cost less.

In addition, when hiring independent contractors instead of employees, you have reduced exposure to some types of lawsuits, such as those alleging job discrimination or wrongful termination.

Finally, and sometimes most importantly, independent contractors provide a level of flexibility that cannot be obtained with employees. Independent contractors are paid to accomplish only a specific task, allowing you to receive specialized expertise for a short period of time. Therefore, there are no problems related to laying off or firing an employee. Moreover, an experienced independent contractor can be productive immediately, eliminating the time and expense involved in training employees.

Despite the advantages, there are laws that must be followed when classifying someone as an independent contractor. If an independent contractor is classified wrong and technically should be an employee, the consequences can be economically devastating. Back taxes would be owed to the IRS, with interest, plus a penalty of 12% to 35% of the tax bill. Also, benefits would be required to be paid to the individual for the time they should have been classified as an employee, such as lost contributions to the retirement plan.

Audits by state agencies are even more common than IRS audits. State audits most frequently occur when workers classified as independent contractors apply for unemployment compensation after their services are terminated. An investigation by the state unemployment compensation agency will ensue, and you will be subject to fines and penalties if it is determined that workers should have been classified as employees for unemployment compensation purposes.

Another major disadvantage of hiring independent contractors is that they can sue you for negligence if they are injured on the job. This is something employees covered by workers' compensation normally cannot do. To reduce the risk of this disadvantage, the independent contractors can be required to have their own workers' compensation insurance.

To be sure an independent contractor is classified correctly, the IRS 20-Factor Test should be used. This test consists of 20 questions that the library must ask themselves to make sure the independent contractor is classified correctly.

1. Instructions – Are detailed instructions given as to how to perform the work? If yes, employee.
2. Training – Is the person required to attend specific training sessions and meetings, and work with another employee? If yes, employee.
3. Integration – Are the services provided integrated into the library so that there is a certain amount of control by the library of those services? If yes, employee.
4. Services Rendered Personally – Are services rendered personally? If yes, employee.
5. Hiring, Supervising, and Paying Assistants - Is the person allowed to hire and pay their own assistants? If yes, *independent contractor*.
6. Continuing Relationship – Is the relationship on a continuing basis? If yes, employee.
7. Set Hours of Work – Does this person have set hours of work? If yes, employee.
8. Full Time Required – Must the person devote full time hours? If yes, employee.
9. Doing Work on Employer's Premises – Must the person perform the work on premises or are they able to perform the work elsewhere? If it must be on premises – employee.
10. Order of Sequence Set – Must the person perform the work in an order set by the library? If yes, employee.
11. Oral or Written Reports – Does the person have to submit regular reports? If yes, employee.
12. Payment by Hour, Week, Month – How is this person paid? If paid by the job or commission, *independent contractor*.
13. Payment of Business and/or Traveling Expenses – Is the person paid for these expenses? If yes, employee.
14. Furnishing of Tools and Materials – Is the person given significant tools, materials to use? If yes, employee.
15. Significant Investment – Does this person contribute a significant investment in their facility? If yes, *independent contractor*.
16. Realization of Profit or Loss – Can this person realize a profit or loss? If yes, *independent contractor*.
17. Working for More Than One Firm at a Time – Can the person do this? If yes, *independent contractor*.
18. Making Service Available to General Public – Does the person do this? If yes, independent contractor?
19. Right to Discharge – Can this person be discharged? If yes, employee.
20. Right to Terminate – Can this person terminate at any time without incurring liability? If yes, employee.

Generally these factors are used to determine the amount of “control” – or ability to direct and manage -- there is over the individual. The more control the library has over the individual, the more chance that this person is an employee.

On the other hand, when compensating an employee, federal and state taxes must be paid as stated above and mandated benefits must be given. Also, many other benefits are given to employees to be competitive in the market. Costs for health insurance, dental and vision insurance, life insurance, disability, retirement plans, and paid time off usually add up to at least 25-30% of payroll as stated above.

Managing an employee's performance and compensation plan takes much more time than with an independent contractor. Employees should be given a performance review annually consisting of feedback on prior year performance and setting goals for the next year. This information needs to be monitored throughout the year to keep the employee motivated and focused on attaining the set goals. Even though this takes more time than simply forming a contract for a specific project with an independent contractor, the library has more ability to manage and influence employees and in return hopefully a higher level of devotion from an employee.

When deciding whether or not to hire an independent contractor or another employee, take these issues into consideration, weigh your options depending on the recruiting market and your needs, and make the best decision for the library and its goals.

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