

Full Time Employee vs Independent Contractors

As a business grows and evolves, business owners and managers must hire employees and independent contractors to perform tasks. An employee might leave or growth could require the hiring of an additional employee. The company might need to hire a contractor to perform bookkeeping or do construction on a building.

Both employees and independent contractors have specific roles to play within an organization. The decision of whether to hire a contractor or an employee is made for both business and legal reasons.

The difference between independent contractor and employee

In the eyes of the IRS, an independent contractor and an employee are completely different. An employee signs a W-2 form and is legally part of an organization. The employer cuts a paycheck to the employee, and employee most likely works in the business owners' establishment. That could be anything from a restaurant to an office or a warehouse.

An independent contractor owns a business and is hired to do a specific task. The independent contractor files taxes as a business owner, and the company receives a W-9 form with the contractor. The independent contractor might work onsite, say to fix an electrical problem, but the contractor could also work offsite and submit the work. An example is hiring a CPA.

Advantages of hiring a contract worker

A company can save money hiring a contractor. A company is not required to pay social security and other payroll taxes to the government. The contractor files business taxes and pay them. The company is also not required to pay benefits like paid vacation and health insurance. In general, hiring and paying a contractor requires much less paperwork.

Flexibility is another advantage. A contractor is available on an as-needed basis. A graphic designer could be hired for specific projects, so the company does not have to absorb the cost of a full-time employee. Contractors can be hired for specific tasks as business ebbs and flows.

Disadvantages of hiring an independent contractor

The company does not set the daily work agenda for an independent contractor. The company must work with the contractor and establish a schedule with the contractor. If a project is under a tight deadline, an independent contractor might not be the best choice. The independent contractor has other clients, and that might interfere with getting work done quickly.

If a company wants to develop strong morale and company culture, an independent contractor might hurt those efforts. The contractor is not loyal to the company like an employee. An employee will promote and enhance the company's brand, but independent contractors are in business for themselves. They want to advance their own brand and company.

Independent contractors are generally more expensive on a per-hour basis. In exchange for not paying taxes and providing benefits, independent contractors charge a higher rate than employees. While the actual amount will vary depending on the industry and the specific contractor, the rate can be significantly higher than employee.

Advantage of hiring an employee

Employees are an important part of any organization. They are loyal and are interested in advancing the company's interest. Employees are onsite everyday and take direction from a manager or the owner of the company. They will work extra hard and make sure the job is completed right. Employees can be counted on to deliver in a time crunch.

The cost is significantly less per hour for an employee. Employees gain stability, but in exchange, they receive less compensation than a contract employee. An employee gives a company loyalty at a lower rate in exchange for having a place to work everyday.

Company morale and culture are enhanced with employees. Employees are members of a team, and that shared culture can be vital to the future success of a business. The informal "water cooler" talk in the office plays an important role in building team unity each day. Culture is built through the shared experiences of the employees, and that does not happen with independent contractors.

Disadvantages of hiring an employee

Benefits are usually the main disadvantage of hiring an employee, because that adds to the cost. While the law does not require companies to provide benefits, most companies offer some form of benefits to full-time employees. Healthcare, paid vacation and retirement are some of the main benefits offered to employees.

Cash flow can also be a reason. Some flexibility exists for paying a contractor, but employees receive a paycheck on a set day. Companies can wait for payment from somebody before paying a contractor, but it must have the money available immediately for an employee.

As well, supervision can be a disadvantage of an employee. A company is responsible for managing the day-to-day activities of an employee. A contractor is usually given some direction, but the person manages daily activities. The contractor does not need ongoing supervision. Some companies can find daily management difficult.

Companies are also required to pay workmen's compensation when an employee is hurt on a job. That can be common in construction and manufacturing, and companies often try to limit their workmen's compensation exposure.

Rules regarding employees versus independent contractor

While an independent contractor is often the choice many companies prefer, it's not always legal. The IRS is very specific about when a person must be classified as an employee. The IRS says the general rule is "that an individual is an independent contractor if the payer has the right to control or direct only the result of the work, not what will be done and how it will be done." That means if the person works onsite and has a daily manager he or she is an employee. Also, an independent contractor generally has other clients where as an employee's sole income is from the company.

A company who misclassifies a person intentionally is required by the IRS to pay employment taxes and penalties. A person can even petition the IRS if he or she believes the company has misclassified a person's status. The worker can file a Form SS-8 (Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding). The IRS wants to prevent companies from taking advantage of workers.

In California, the presumption is that the person is an employee. According to Labor Code Section 3357, "Any person rendering service for another, other than as an independent contractor, or unless expressly excluded herein, is presumed to be an employee." That does not mean that a person is automatically classified as an employee in California. Several tests are applied by the state where the classification of somebody is unclear.

The penalties can be stiff in California. A company that willfully misclassifies a person in California faces a fine between \$5,000 and \$15,000 per misclassified worker, and a company with a pattern of misclassifying workers can face fines between \$10,000 and 25,000 per violation.