

PRO Unlimited

Net Take-Home Pay 1099 Contractor vs. W-2 Employee

Contractors directed to a payroll service are often concerned that they will lose all their deductions, pay more taxes and take home less money. Here are some facts that may help contractors in understanding what to expect when they are payrolled (W-2), rather than engaged as an independent contractor (1099).

Many independent contractors have home offices, no employees and typically very few “fixed-overhead” type expenses. The effect of losing these types of business deductions is negligible when you consider the cost of Self-Employment (SE) taxes. Remember, as an independent contractor, the individual is responsible for up to 16.2% FICA taxes (Social Security/OASDI 12.4% and Medicare 2.9%-3.8%). However, as an employee, the individual is only responsible for up to 8.55% FICA Taxes (half of the 12.4% Social Security/OASDI and Medicare 1.45%-2.35%), the employer (PRO) is responsible for the other 7.65%.

The following table compares the tax liability for a W-2 employee and a 1099 contractor/self-employed individual with relatively low business expenses, married with two children, using the tax rate schedules provided by the IRS:

	1099	W-2	1099	W-2	1099	W-2	1099	W-2	1099	W-2
Gross Receipts/Wages	\$75,000	\$75,000	\$100,000	\$100,000	\$150,000	\$150,000	\$200,000	\$200,000	\$250,000	\$250,000
Less Expenses ¹	(\$3,000)	\$0	(\$5,000)	\$0	(\$6,000)	\$0	(\$8,000)	\$0	(\$8,000)	\$0
Net Income	\$72,000	\$75,000	\$95,000	\$100,000	\$144,000	\$150,000	\$192,000	\$200,000	\$242,000	\$250,000
Less Adjustments/Deductions										
1/2 of Self-Employment Tax ²	(\$5,087)	\$0	(\$6,712)	\$0	(\$9,275)	\$0	(\$9,918)	\$0	(\$10,588)	\$0
Health Insurance-1099 ³	(\$18,600)	\$0	(\$18,600)	\$0	(\$18,600)	\$0	(\$18,600)	\$0	(\$18,600)	\$0
Health Insurance -W-2 ³	\$0	(\$350)	\$0	(\$350)	\$0	(\$350)	\$0	(\$350)	\$0	(\$350)
Standard Deductions ⁴	(\$12,600)	(\$12,600)	(\$12,600)	(\$12,600)	(\$12,600)	(\$12,600)	(\$12,600)	(\$12,600)	(\$12,600)	(\$12,600)
Exemptions ⁴	(\$16,000)	(\$16,000)	(\$16,000)	(\$16,000)	(\$16,000)	(\$16,000)	(\$16,000)	(\$16,000)	(\$16,000)	(\$16,000)
Total Adjustments/Deductions	(\$52,287)	(\$28,950)	(\$53,912)	(\$28,950)	(\$56,475)	(\$28,950)	(\$57,118)	(\$28,950)	(\$57,788)	(\$28,950)
Less Taxes⁵										
Taxable Income (FIT)	\$19,713	\$46,050	\$41,088	\$71,050	\$87,525	\$121,050	\$134,882	\$171,050	\$184,212	\$221,050
Federal Income Tax	(\$2,036)	(\$5,989)	(\$5,239)	(\$9,739)	(\$13,469)	(\$21,850)	(\$25,308)	(\$34,350)	(\$37,641)	(\$46,850)
FICA Tax (Social Security, Medicare) ⁶	(\$10,173)	(\$5,711)	(\$13,423)	(\$7,623)	(\$18,551)	(\$9,517)	(\$19,836)	(\$10,242)	(\$21,175)	(\$13,214)
Total Tax	(\$12,209)	(\$11,700)	(\$18,662)	(\$17,362)	(\$32,020)	(\$31,367)	(\$45,144)	(\$44,592)	(\$58,816)	(\$60,064)
Net Take Home Pay	\$41,191	\$62,950	\$57,738	\$82,288	\$93,380	\$118,283	\$128,256	\$155,058	\$164,584	\$189,586
FICA Tax & Self Employment Adjustment^{2,6}										
Self-Employment Adjustment (SS)	\$5,508		\$7,268		\$9,435		\$10,131		\$10,856	
Social Security Taxable Earnings	\$66,492	\$74,650	\$87,733	\$99,650	\$118,500	\$118,500	\$118,500	\$118,500	\$118,500	\$118,500
Social Security Tax	\$8,245	\$4,628	\$10,879	\$6,178	\$14,694	\$7,347	\$14,694	\$7,347	\$14,694	\$7,347
Self-Employment Adjustment (MED)	\$5,508		\$7,268		\$11,016		\$14,688		\$18,513	
Medicare Taxable Earnings	\$66,492	\$74,650	\$87,733	\$99,650	\$132,984	\$149,650	\$177,312	\$199,650	\$223,487	\$249,650
Medicare Tax	\$1,928	\$1,082	\$2,544	\$1,445	\$3,857	\$2,170	\$5,142	\$2,895	\$6,481	\$5,867
Total FICA (SE) Tax	\$10,173	\$5,711	\$13,423	\$7,623	\$18,551	\$9,517	\$19,836	\$10,242	\$21,175	\$13,214
Tax Deduction Portion (1/2 of SE Tax)	\$5,087		\$6,712		\$9,275		\$9,918		\$10,588	

¹ Schedule C business expenses deductible for 1099 recipient would be paid by the employer for the W-2 worker. Expenses are based on estimated average for independent contractors and assumption that as gross receipts increase, expenses increase as well – see below example.⁹

² One-half of the social security and Medicare amount paid as self-employment taxes by 1099 workers is deductible for income taxes purposes.

³ Health Insurance: Generally speaking, the cost of health insurance premiums for the self-employed may be fully deductible from income tax for any months the self-employed individual was not eligible under his/her own employer's plan or the plan of his/her spouse's employer. However, the rules regarding the deductibility of health insurance premiums are complex and the value of the deduction, if any, can vary substantially depending upon the independent contractor's individual circumstances. For purpose of this comparison, we have (1) assumed the independent contractor is paying the entire cost of his or her individual health insurance and that it is fully deductible from gross income; and (2) the W-2 worker pays 50% of his or her employer's health insurance expense for that worker, and cannot deduct that cost from W-2 earnings. We have further assumed that monthly premium for each worker is \$1,550, based on national averages.

⁴ Standard Deduction and Exemptions for a family of four and Married Filing Jointly income tax determined by using IRS Tax Rate Schedules and amounts in effect at time of print. (Standard deduction: \$12,600; Exemptions: \$4,000 x 4 = \$16,000).

⁵ Taxable wage includes adjustment for deductible health insurance.

⁶ FICA rates and wage base limits in effect at time of print: Social Security: 6.20% tax (12.4% for Self Employed) on the first \$18,500 of taxable wages. Medicare: 1.45% (2.9% for self-employed) on the first \$200,000 of taxable wages, 2.35% (3.80% for self-employed) for the taxable wages above \$200,000.

⁹ Deductible business expense example of \$3,000 includes the following expenses: \$1,334 Equipment (\$4,000 / 3 Years); \$500 Office Supplies; \$600 Home Office Expenses; \$566 Other Expenses. Home office assumption based on 3000 sq. ft. home and 300 sq. ft. of office space, \$12,000 annual cost x 10% (300/3000) = \$1,200 x 0.5 (0.5 assumes half of independent contractors qualify for deducting home office expense due to “exclusive use” test). Per the IRS to qualify under the “exclusive use” test, you must use a specific area of your home only for your trade or business. You do not meet the requirements of the exclusive use test if you use the area in question both for business and for personal purposes.