Avoid These 1099 “Employee” Pitfalls

As financial planners we are seeing more and more individuals, especially in the software development and technology space, hired by companies as “1099 employees”. “1099 employees” is an ironic statement because if a company is paying you via a 1099 technically you are not an “employee” you are a self-employed sub-contractor. It’s like having your own separate company and the company that you work for is your “client”.

There are advantages to the employer to pay you as a 1099 sub-contractor as opposed to a W2 employee. When you are a W2 employee they may have to provide you with health benefits, the company has to pay payroll taxes on your wages, there may be paid time off, you may qualify for unemployment benefits if you are fired, eligibility for retirement plans, they have to put you on payroll, pay works compensation insurance, and more. Basically companies have a lot of expenses associated with you being a W2 employee that does not show up in your paycheck.

To avoid all of these added expenses the employer may decide to pay you as a 1099 “employee”. Remember, if you are a 1099 employee you are “self-employed”. Here are the most common mistakes that we see new 1099 employees make:
Making estimated tax payments throughout the year

This is the most common error. When you are a W2 employee, it’s the responsibility of the employer to withhold federal and state income tax from your paycheck. When you are a 1099 sub-contractor, you are not an employee, so they do not withhold taxes from your compensation………..that is now YOUR RESPONSIBILITY. Most 1099 individuals have to make what is called “estimated tax payments” four times a year which are based on either your estimated income for the year or 110% of the previous year’s income. Best advice……..if 1099 income is new for you, setup a consultation with an accountant. They will walk you through tax withholding requirements, tax deductions, tax filing forms, etc. It’s very difficult to get everything right using Turbo Tax when you are a self-employed individual.

Tracking mileage and expenses throughout the year

Since you are self-employed you need to keep track of your expenses including mileage which can be used as deductions against your income when you file your tax return. Again, we recommend that you meet with a tax professional to determine what you do and do not need to track throughout the year.

The tax return is prepared incorrectly

No one wants a love letter from the IRS. Those letters usually come with taxes due, penalties, and a “guilty until proven innocent” approach. There may be additional “schedules” that you need to file with your tax return now that you are self-employed. The tax schedules detail your self-employment income, deductions, estimated tax payments, and other material items.

Important rule, do not cut corners by reducing the gross amount of your 1099 income. This is a big red flag that is easy for the IRS to catch. The company that issued the 1099 to you usually reports that 1099 payment to the IRS with your social security number or the Tax ID number of your self-employment entity. The IRS through an automated system can run your social security number or tax ID to cross check the 1099 payment and 1099 income to make sure it was reported.

Legal protection

As a 1099 sub-contractor, you have to consider the liability that could arise from the services that you are providing to your “client” (your employer). As a self-employed individual, the company that you “work for” could sue you for any number of reasons and if you are operating
the business under your social security number (which most are) your personal assets could be at risk if a lawsuit arises. Advice, talk to an attorney that is knowledgeable in business law to discuss whether or not setting up a corporate entity makes sense for your self-employment income to better protect yourself.

**About Greenbush Financial Group**

Greenbush Financial Group, LLC is an independent registered investment advisory firm located near Albany, NY. The firm offers employer sponsored retirement plans, fee based financial planning, and investment management services.

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