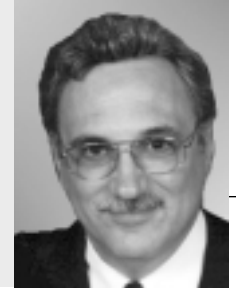


By Carl Davidson

## About the Author

Carl Davidson is the founder and president of Sales & Management Solutions. This New York-based company has been offering video and live training for the water equipment industry for almost 20 years. To find out more, call Davidson at 800-941-0068.



# Feeling Lucky?

## The Truth About 1099 Contractors

I am surprised at seminars when people tell me they hire their salespeople as 1099 independent contractors. We do not recommend this for business and tax reasons. This article discusses why we believe you are at a disadvantage using this method of remuneration.

### Business Disadvantages

**Harder to recruit.** Good salespeople are looking for more than money. Very few good salespeople leave their jobs because they aren't making money. Many leave because they want to join a team that respects them and that will be a career for years to come. If your company hires independent contractors, you are telling them that they are not joining your team, that you will not

contribute to their social security or vacations, and this is not how to retain great salespeople.

**Attracts wrong group.** Most salespeople who want to be 1099 contractors think it saves them money. That is because they get their gross check and not the net. People who believe this tend not to file up-to-date tax returns. If they were tax savvy, they would realize that you are not saving them money, you are costing them their self-employment tax, which

is 15.3 percent of everything they make. This tends to attract people who may not file tax returns and may not live up to their IRS obligations. Many cannot concentrate on selling because they are being pursued by the IRS. We believe you will do better by hiring salespeople who understand the tax act and fulfill all their obligations.

**Sends wrong message.** When you hire someone as an independent contractor, you are telling him he can set his own rules. This means he can decide what to say in the demo, how to prospect, whether to participate in shows and what to wear. You cannot tell him what to do and this robs you of the authority you need to supervise him and help him realize his true potential.

**May result in lawsuits.** Many independent contractors who are unsuccessful and leave sue the company for not sending in deductions. Others sue the company for disability and workmen's comp claims. If you have no written contract, you especially are vulnerable since it will be unclear in court as to exactly what was the basis of their relationship

with you. If you have a written agreement that specifies the relationship, you are better off. Still, many liberal judges side with the "poor employee" who "didn't understand what they were signing" or "signed it under duress of not being paid." Even if you win these suits, how much will it cost you to defend yourself? The upside is far smaller than the potential downside.

### Exactly What Is The Advantage?

What are we trying to save by hiring salespeople as contractors? First, we save some paperwork. If we took short cuts to save paperwork throughout our businesses, we wouldn't collect sales tax or file tax returns. Payroll deductions are just another obligation of the businessperson. If you are unwilling to do the job right, maybe being in business is not your strong point.

Owners also tell me they save approximately 7 percent of total earnings in FICA taxes and workmen's compensation. Let us say the total saving is 12 percent. For an average salesperson who earns \$35,000 per year, that is a saving of \$4,200. When you consider the potential fines and penalties from the IRS, potential lawsuits and legal fees and the loss of revenue from not properly supervising your team and demanding performance, is it worth it?

### Do High Commission Rates Motivate?

Our experience is they do not. We have noticed that dealers who pay a smaller commission combined with good benefits, security and opportunity tend to sell more and get better performance. One great manager we know has tracked results, and he has found that salespeople under his tight system of supervision have earned two to three times what they made in unsupervised environments. Many dealers pay a high commission and expect team members to supervise themselves. This almost always is disappointing for two reasons. First, if people could motivate themselves, no sports teams would have coaches, no army would have generals and no church would have hierarchy. Second, high commission demotivates. Let us say you pay \$1,500 per sale. How many salespeople will sell more than once in a week? I know the hope of gain motivated you, that is why you own or manage a company. Most salespeople are more motivated by things other than commission.

### Everyone Else Is Doing It

Many dealers fail to realize that the world has changed since the '70s. People

## Would You Like To Know How Others Pay Their Sales Team?

Carl Davidson is conducting research into how dealers pay their sales teams and how much they pay them. We invite you to answer a questionnaire that will be kept in confidence about your payroll practices. To thank you for participating, you will receive a copy of the final survey results. No names will be used and your information will be kept in strict confidence. All it takes to participate is filling out a simple survey by phone or email. To participate and find out how you stack up with others in the industry, e-mail us at davidson@salesco.net or call 800-941-0068.

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are different and are motivated by different things. Is your method of remuneration attracting the right number of great people, and are they motivated? If not, maybe paying people the way we did 30 years ago isn't working for you.

### Tax Disadvantages

The IRS and the courts have set out criteria that indicate whether a person is an independent contractor or an employee. I visited their website and researched this matter. Take a look at some of the matters they raise and ask yourself if your salespeople meet the criteria. No single criterion is sufficient. In the end, it may be up to a court to decide.

The IRS looks at several broad areas to determine a person's status.

- **Behavioral control.** If a person receives extensive training or instructions on how to do the work or which tools to use, that would indicate they are employees. So, if

you have sales meetings, if you supply kits, if you supply a pitch book, these all are indications of an employee/employer relationship.

IRS publication 963 also mentions things such as uniforms and signs. If you supply corporate clothing or signs for cars, that is an indication of an employee/employer relationship. Another indication is a performance review procedure. If you review performance regularly, that indicates your team is made up of employees.

- **Financial control.** The IRS maintains that contractors have "significant investments." They own their own trucks, tools, etc. If a person is supplied with a phone, kit, tools, stationary, office and other items at no cost, that is an indication of an employee.

The more expenses the person is not reimbursed for, the greater the

indication that they are a contractor. If you pay for travel costs, factory training, business cards, trade shows, parking or lunches at shows, car expenses or liability insurance, these all are indications of an employee.

Written contracts are a must if you have any hope of convincing the IRS that your team is made up of contractors, but contracts will not help if other matters indicate the contrary.

The IRS looks at other indications as well.

- **Offerings to the public.** If a person advertises to the public, maintains an office, has a private logo and identity or works for more than one entity, these are indications of a contractor. If your team uses your stationary and logo, phone, office, uniforms and works only for you, those all are indications of an employee.

- **Permanency.** If a person is retained for a specific project and it is completed, that is an indication of a contractor. However, if a team member is retained on a permanent basis until terminated, that is an indication of an employee.

I think you will agree that if you look at your company and its relationship with its workers, chances are that you may be judged as an employer. If you are, you may be liable for all taxes that should have been deducted, in addition to interest and fines.

Do you feel lucky? If you are completely happy with your remuneration program, and it is helping you recruit the correct number of great salespeople and you feel you meet the criteria of a contractor relationship, then carry on. If you are not happy with the performance of your plan or the potential liabilities, this may be a good time to consider revising it. **WQP**

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