

Being a Consultant, Freelancer, or Contractor: Pros and Cons

Consulting or freelancing as an independent contractor has benefits and drawbacks.

Freelancers and consultants are known as "independent contractors" in legal terms. An independent contractor (IC) is a person who contracts to perform services for others without having the legal status of an employee. Most people who qualify as independent contractors have their own trade, business, or profession -- that is, they are in business for themselves.

Good examples of ICs are professionals or tradespeople with their own practices, such as doctors, graphic artists, accountants, plumbers, and carpenters. Independent contracting is also common in highly specialized or technical fields, such as computer programming, engineering, and accounting. You can find ICs in almost every field, from construction to marketing to nursing. Any person who is in business for himself or herself qualifies as an IC.

Some people seek to become ICs, while others have the status thrust upon them. Whichever group you fall into, working as an IC has both benefits and drawbacks.

Advantages of Working as an Independent Contractor

Independent contractors reap many rewards that regular wage earners may never experience.

You are your own boss.

When you're an IC, you're your own boss, with all of the risks and rewards that entails. You can choose how, when, and where to work, for as much or little time as you want.

ICs are masters of their economic fate. The amount of money they make is directly related to the quantity and quality of their work. This is not necessarily the case for employees. ICs don't have to ask their bosses for a raise -- if they want to earn more, they just have to go out and find more work or raise the amount they charge. And, because most ICs are not dependent upon a single company for their livelihood, the hiring or firing decisions of any one company don't impact ICs like they do employees.

You may earn more than employees.

You can often earn more as an IC than as an employee in someone else's business. For example, an employee in a public relations firm decided to become an IC when she learned that the firm billed her time out to clients at \$125 per hour while only paying her \$17 per hour. She charges \$75 per hour as an IC and makes a far better living than she ever did as an employee.

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According to *The Wall Street Journal*, ICs are usually paid 20% to 40% more per hour than employees performing the same work. Hiring firms can afford to pay ICs more because they don't have to pay Social Security taxes or unemployment compensation taxes, provide workers' compensation coverage, or provide employee benefits like health insurance and sick leave.

Of course, how much you're paid is a matter for negotiation between you and your clients. ICs whose skills are in great demand may receive far more than employees doing similar work.

You may pay lower income taxes.

Being an IC also provides you with many tax benefits that are not available to employees. For example, no federal or state taxes are withheld from your paychecks, as they must be for employees. Instead, ICs have to pay estimated taxes directly to the IRS four times a year. This means you can hold on to your hard-earned money longer before you have to turn it over to the IRS. Moreover, it's up to you to decide how much estimated tax to pay (but there are penalties if you underpay). This flexibility gives you more control over the money you earn.

You can also take advantage of many business-related tax deductions that are not available to employees. When you're an IC, you can deduct from your taxable income any necessary expenses related to your business, as long as they are reasonable in amount and ordinarily incurred by businesses of your type. This may include, for example, office expenses (including costs associated with a home office), travel expenses, entertainment and meal expenses, cable TV and magazine expenses, equipment and insurance costs, and much more.

ICs can also establish tax-advantaged retirement plans such as SEP-IRAs and Keogh Plans. This enables you to shelter a substantial amount of your income until you retire.

Because of these tax benefits, ICs often pay less tax than employees who earn similar incomes.

Disadvantages of Working as an Independent Contractor

Despite the advantages, being an IC is not always a bed of roses. Here are some of the major drawbacks.

No job security.

When you're an employee, you must be paid as long as you have your job, even if your employer's business is slow. This is not the case when you're an IC. If you don't have business, you don't make any money. As one IC says, "If I fail, I don't eat. I don't have the comfort of punching a time clock and knowing the check will be there on payday."

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No employer-provided benefits.

Many employers provide their employees with health insurance, paid vacations, and paid sick leave. More generous employers may also provide retirement benefits, bonuses, and even employee profit sharing.

When you're an IC, you get no such benefits. You must pay for your own health insurance, often at higher rates than employers have to pay. Time lost due to vacations and illness comes directly out of your bottom line. And you must fund your own retirement. If you don't earn enough money as an IC to purchase these items yourself, you will have to do without.

No unemployment insurance benefits.

ICs also don't have the safety net provided by unemployment insurance. Hiring firms do not pay unemployment compensation taxes for ICs, and ICs can't collect unemployment when their work for a client ends.

No employer-provided workers' compensation.

Hiring firms do not provide workers' compensation coverage for ICs. If a work-related injury is an IC's fault, he or she has no recourse against the hiring firm.

Few or no labor law protections.

A wide array of federal and state laws protect employees from unfair exploitation and discrimination by employers. Very few of these laws apply to ICs.

Risk of not being paid.

Some ICs have great difficulty getting their clients to pay on time or at all. When you're an IC, you bear the risk of loss from deadbeat clients.

Liability for business debts.

Finally, most ICs are personally liable for the debts of their businesses. An IC whose business fails could lose most of what he or she owns.