

CONSULTANT'S ADVOCATE

4 Things Every Computer Consultant Should Know About Self-Employment

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The author, Thomas J. Raef, and the publisher, Consultant's Advocate, have made all reasonable efforts to put together an e-book that will be useful for people venturing into the exciting field of computer consulting and have tried to ensure that the information in this book is helpful, correct and current.

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This e-book was created to provide you with some information about being a computer consultant. To learn all my marketing techniques obtain a copy of my e-book, "Consultant's Guide to Becoming Gainfully Self-Employed". This e-book has 375 pages of the methods I've used during my 20 year career as a computer consultant.

If you're seeking to learn about the business aspects of computer consulting, purchase my e-book, "Consultant's Guide to Being Gainfully Self-Employed". This e-book covers business insurance, taxes, accounting, incorporating and retire planning.

Both e-books are available on my web site at www.consultantsadvocate.com.

CHAPTER 1. W2 TO 1099 – WHAT’S THE DIFFERENCE?.....	4
CHAPTER 2. FOCUS ON VALUE!.....	10
CHAPTER 3. WHAT TAXES SHOULD YOU PAY?.....	13
CHAPTER 4. FINDING PROJECTS.....	21

Chapter 1.

W2 to 1099 – What's the Difference?

How much should I charge?

This is the question many newcomers as well as old-timers ask. After all it determines how much money we make, right?

If you don't set your rates high enough, you'll feel cheated. Maybe less enthusiastic about the work you're doing.

On the other hand if you charge too much, you won't find any work.

Like one consultant I talked with years ago, "My rate is \$250 an hour!". I asked, "How many hours do you work a month?"

To which he replied, "I can only find a few companies able to pay me what I ask so I only work about 10 hours a month."

Well, hoopy-do!

If you're coming from the ranks of permanent employment, or considering a change to the wonderful world of self-employment, you

want to know where to set your rates so you can make a little more than you are as a “captive”.

Before I get into setting your rates, you have to understand a common term used in the consulting profession – “corp to corp”.

Usually you’ll hear this term used from a recruiter or broker, but sometimes I’ve heard it from direct clients as well.

What it means is billing will be handled on a corporation to corporation basis. That means one corporation to another. It doesn’t mean one corporation, the client, to a 1099 self-employed consultant.

Don’t think 1099 and being incorporated are the same. They’re not. As a 1099 you pay self-employment taxes. You’re responsible for the debts of your company. As a corporation, you’re an employee, your corporation is the employer.

Even if you’re the only employee, you’re not self-employed. You’re an employee of the corporation.

If you’re talking with a client and they tell you they only work on a “corp to corp” basis, do not tell them you can work with this unless you’re already incorporated or intend on incorporating immediately.

Got it? Good.

Now, back to setting hourly rates...

I saw this question online:

"I am a computer consultant making \$80 an hour on a W2. I am in the process of changing from a W2 status to a 1099(or corp to corp). How much more should I have my company pay me to offset social security and other related expenses out of my pocket.

I'll give you the full version.

Your employer pays 7.65% as their portion: 6.2% for Social Security and 1.45% for Medicare. If you look on your pay stub, you'll see you pay 6.2% for Social Security and 1.45% for Medicare as well.

When you work as a 1099 you're considered self-employed. I know, thank you Dr. Obvious. However, many people think when they incorporate they're still self-employed - you're not - technically. When you incorporate you're considered an employee of the corporation, not self-employed.

So as a gainfully, self-employed computer consultant you're responsible for both the employer's and employee's portions of Social Security and Medicare.

Medicare ($1.45\% \times 2 = 2.9\%$) is paid on the full amount of your net income. Social Security ($6.2\% \times 2 = 12.4\%$) is paid only up to the current ceiling. For 2001 this ceiling is \$80,400. It goes up to \$84,900 in 2002.

If you have \$160,000 in net income, you would pay Medicare (2.9%) on the full \$160,000. However, you would only pay Social Security on the first \$84,900 (2002 ceiling).

If you're being paid \$80 per hour on a W-2 and working 40 hours per week your current situation looks like this:

$$\$80 \times 40 \text{ hours} = \$3,200 \text{ per week} \times 50 \text{ weeks} = \$160,000$$

You are paying the employee's portion of Social Security (6.2%) and Medicare (1.45%), in addition to your normal portion of the same amounts, which would be:

$$\$84,900 \text{ (Social Security ceiling for 2002)} \times 6.2\% = \$5,263.80$$

$$\$160,000 \times 1.45\% = \$2,320 \text{ (Medicare gets paid on full amount of income)}$$

For a total of \$7,583.80 as the "employer's" portion.

Being self-employed you get to take your net income and multiply it by .9235 to determine your Adjusted Gross Income, but we'll consider that a bonus.

So as long as you're paid \$160,000 + \$7,583.80 you'll be making the same amount as a 1099 as you were as a W2, except for benefits.

$$\text{If you take } \$167,583.80 / \$160,000 = 1.047$$

Multiply your \$80 an hour by this factor (1.05 we rounded up) you get \$84 per hour.

This is what you should get in order to make the same amount. But who wants to just make the same amount? Ask for \$85 - \$90.

This is just for income. It does not include benefits such as employer contributions to a 401k plan, health insurance or any other benefits.

That answers the individual's question.

How about you?

If you're currently a "captive", how much should you charge?

Follow the same basic formula. Determine what your hourly rate is now and do the math. To be more accurate add in the amounts your employer pays in health insurance, retirement plans and any other benefits.

For a quote on health insurance, go to a site like www.ehealthinsurance.com or www.insurancenoodle.com to determine what comparable coverage will cost you as an independent consultant.

When you've determined how much you should charge to make a decent living as a consultant you have to verify the hourly rate is possible in the current economic climate.

Go to www.realrates.com, read what others with your skill set are able to receive as consultants. This will further validate your rate.

If you determine you need to make \$65 per hour to be ahead of where you're at now and the "market" is only paying an average of \$45 per hour, you're probably not ready to get into the market – yet.

However, if you have many years of experience in some hot new technology, which of course is impossible, because if it's hot, it's new, if it's new you can't have years of experience with it, you could strike out and set your rates higher than the average.

One way to get higher rates is to focus on value.

Value?

Yes value.

How?

I'm glad you asked...

Chapter 2.

Focus on Value!

What is value?

It's different for everybody. It can be additional sales, more traffic, better customer service, higher conversion rate, fewer help desk calls, or less employee turnover.

Basically it's what people will pay for. Is it based on reality?

Nope.

It's based on perception. If a person perceives something to have value, it does to them. To a different person, it doesn't.

But it's the difference between "doing a web-site" and "incorporating your business into the world economy."

Do you "feel" that difference?

If a prospective client asks you what you charge to do a web site and you answer "\$150 per page", you've opened the door to someone who focuses on value to steal this client from you.

If a prospective client asks you what you charge to do a web site, ask

"what do you want to accomplish with this web site?"

By asking that question, you've redirected their attention from price and placed it on value. What do they want out of the web site? Then your next question is, "What will it mean to you to have a web site functioning this way?" What you're trying to draw out of them is what price have they placed on the benefits of this web site.

If they say, "it will cut our costs of customer service by \$50,000 a month, immediately", you've just helped them focus on what they will gain by having this web site.

Keep asking questions until you see the wheels turning in their heads about how much money this will either save them or make them.

If they keep coming back to what you will charge, keep bringing their focus back to what value you will provide them by completing this project. Get them thinking about what life will be like when your finished.

You'll know when you get them to this point when they ask "how soon can you begin and when will you be finished?".

I've played a game since early on in my career that keeps me focused on benefits, on value.

I call it the "so what?" game. Every time I think about saying something to a prospective client, I ask myself "so what?" and I keep on asking myself this until I can't answer it anymore.

For instance, if I'm about to tell them I will produce content for their web site, I ask myself "so what?". Then I re-work the statement into a benefit. "I will save you the time of researching and producing the content for your site. This will give you time to focus on marketing your site and your products." And continue with, "that's what you like doing, right?" "You don't get paid to write content, you get paid when somebody buys something on your site, correct?"

Paint a clear picture in their head. Get them to fully understand what it is you can do for them and you'll have them focused on value.

Price becomes almost second nature to them. Have you ever been the lowest bidder on a project and still not gotten it? If not, you haven't been bidding very much.

Why is it you lost those bids, even though you were the lowest bidder? Value. That's why.

Someone else showed the client how their proposal, even though more expensive, provided so much more value than anyone below them.

Focus on: benefits to the client and value. Price, or hourly rate will be less of an issue.

Chapter 3.

What Taxes Should You Pay?

Why do we want to be independent consultants?

The freedom it gives us, right?

Well, fellow consultants, many of the people that *were* consultants have fallen to the temptation of the tax devil.

You see, when you get paid from a client as a 1099 consultant, there are no taxes deducted like when you were an employee. This doesn't mean you don't owe any taxes, nor does it mean you don't have to pay taxes. It means you still owe taxes and you still ***must*** pay taxes, however, you can keep the money in your hands a little longer.

Do not ever think you can get away with not paying taxes. The IRS will find you and then fine you. Heavily.

I cannot warn you enough. Pay your taxes and live with it.

How much and when all depends on what type of business structure you choose, either 1099 or incorporate.

I've done both and each has its advantages and disadvantages. I'll discuss them here but I won't go into how to incorporate here. I'll cover that in another section of this e-book.

1099 Tax Status

As a 1099 based consultant, your clients pay you, you deposit their check and you pay quarterly estimated taxes.

Let me restate that, as a 1099 consultant you ***must*** pay quarterly estimated taxes. They aren't optional. They're required.

You do not have the opportunity to wait until April 15th of the following year to pay your taxes. You must pay them quarterly.

Many people fall into the trap of paying as little as possible in estimated taxes and then finding out the government penalizes you for miscalculating your estimated taxes.

You can avoid being penalized by paying at least the smaller amount of :

- 90% of your total tax due for the current year
- 100% of the tax you paid the previous year

These are the minimum amounts the IRS expects you to pay. To calculate your payments you have three different ways:

1. Payments based on last year's taxes
2. Payments based on estimated taxable income
3. Payments based on quarterly income

Let's examine each of these in detail.

1.) Payments based on last year's taxes

Using this method, you use the taxes you paid last year as the basis for how much you'll owe this year. This applies even if you weren't self-employed last year as long as it covers a full twelve month period.

For example, Carol decides in March of 2001 to start her new career as a gainfully self-employed consultant. She looks at the taxes she had deducted from her checks as an employee for last year and divides this amount by four to figure out how much her quarterly payments should be this year. She paid \$10,429.17 in taxes last year. She divides this by four and sees she has to make quarterly payments to the IRS in amounts of \$2,607.30 which she rounds up to an even \$2,610.00. As long as she pays this amount on time, she will avoid penalties from the IRS.

If you're a high income earner the IRS wants more from you. Those of you who had an adjusted gross income (AGI) of more than \$150,000 or \$75,000 for married couples filing separately, must pay more than 100% of your prior year's tax.

You can figure your Adjusted Gross Income by taking your total income and deducting any self-employed health insurance deductions; one-half of your self-employment tax; and any IRA, Keogh and SEP-IRA contributions.

For instance, Jon is a gainfully self-employed consultant who earned a gross income of \$300,000 (what's so gross about that?) in 2000. After

all his deductible expenses his AGI was \$250,000 and he paid \$60,000 in income and self-employment taxes. This year he must pay 105% of the tax he paid last year or 105% of \$60,000 (\$63,000). As long as he pays this \$63,000 in four equal installments of \$15,750 on time, he will not have problems with the IRS for estimated taxes.

A nice little treat the IRS gives us is if by September 15th of the current year, you realize your income for this year will be 25% less than last year, you are given the option of not sending in your last tax payment on January 15th. Please note, you **must** still make the September payment, you are just given the option on the last payment of the year which is due on January 15 of the following year.

Maybe this will clarify the point, Boris made \$300,000 in 2000 as an extremely busy web developer working for numerous dot-coms. This year, 2001, after the shake-out, he realizes his income will not exceed \$225,000, so he has the option of foregoing his estimated tax payment in January of next year. He must still compute his quarterly estimated tax payments on 105% of \$300,000 / 4. But if his predictions are correct, then he can pass on his estimated payment in January of 2002.

If he decides to sub-contract some work out in order to make additional income and he sees that he will make \$350,000 this year, he will not have to increase his estimated payments, just pay the 105% of the \$300,000 from last year, then he will not be penalized by the IRS. Boris will have to make up the underpayment when he files his final tax return on April 15th.

2.) Payments based on estimated taxable income

This method requires more work and is generally only beneficial if you feel you'll make about 30% *less* than you made last year. We don't even want to think about this, because after all, you're reading this material and studying the techniques here because you want to make *more* money. Let's cover it anyway, just so you know.

It requires more work because you have to estimate your income and expenses for the entire year. Where this comes into play is if you take on an extended contract for the entire year and you know you'll make 30% less but you take it because you'll be learning some valuable new technology that you'll be able to use next year and make more money. Start by examining your last year's return. See what expenses you incurred and list them out in a spreadsheet. Create three columns:

Expense 2000	Amount 2000	Amount 2001 (estimated)
Car insurance	\$1,100	\$1,200
Books	\$800	\$600

In the column on the far left list all the expenses you incurred last year. In the second column list the exact dollar amounts, then in the last column, enter how much you think those same expenses will be this year. This will force you to examine each line item from last year's return and determine if you will have the same expense this year.

Other reasons you might make less money than last year is maybe you'll be vacationing more due to the amount of money you made last

year. Maybe you focused entirely on dot-coms and since there aren't as many this year, you'll make less money.

After reviewing your income and expenses for last year and determining which of those will carry-over into this year, you'll be in pretty good shape for determining your taxes for this year. As long as you pay 90% of your taxes in quarterly installments, the IRS will not penalize you. However, you must provide an accurate estimation and pay that amount in quarterly installments, it's just if you don't quite estimate accurately, the IRS can penalize you if you don't pay at least 90% of what you owe for the year.

Here's an example, Richard is a self-employed network engineer who services three accounts on a regular basis, that is, until this year. One of Richard's largest clients has moved their headquarters to Argentina so he knows his income will drop this year. Last year he made \$140,000, with these three clients and paid \$31,000 in taxes. This year he only expects to make about \$84,000 with the loss of his major client. Richard will stay out of trouble with the IRS if he pays at least 90% of the taxes he will owe on his AGI of \$84,000.

Use the IRS form 1040-ES which includes a worksheet for computing your estimated taxes. Or you can use the worksheet, which is IRS Publication 1120-W to estimate your taxes.

3.) Payments based on quarterly income

The third and final method to compute your estimated taxes is based on your quarterly income. This method while more complicated also can provide for more flexibility.

With this method you compute your taxes at four different times of the year; March 31st, May 31st, August 31st and December 31st, spreading your deductions throughout the year. Because your estimated tax payments are based on your actual income for each quarter, this method is ideal if you expect your income to fluctuate greatly over the course of the year.

For instance, if you know this year you'll be doing some small projects for the first half of the year and then you've already made arrangements to start a large project, for hefty fees, in June, it may be worthwhile to compute your taxes based on your quarterly income.

Use IRS form 2210 to file using this method. This form also guides you through the process of computing your taxes with over 40 steps. I strongly urge you to seek the guidance of an accountant for this, or at the very least use a tax preparation program like Turbo Tax or Tax-Cut or any of the other programs out there. Just be sure they include calculations for this method.

You can also read the IRS publication 505 to learn more about all three of these methods.

When should you pay your estimated taxes?

When they're due!

Okay, I'll be a little more specific.

For the period between January 1 and March 31, you pay on April 15th. This is the real killer because frequently, consultants will get caught here because you not only have your tax return for last year due along with any taxes owed for last year, but you also have your estimated payment due at the same time. Don't think that the IRS will let you slide if you make one or the other. They expect *and* want both.

The other due dates are: June 15th for the tax period between April 1st and May 31st; September 15th for the tax period between June 1st and August 31st; and January 15th for the last tax period of the year from September 1st through December 31st.

The January 15th payment is another one people frequently get confused with. This payment is made in January of the following year. So for 2001, you'd be making your last estimated tax payment in January 2002.

I strongly suggest you set-up a separate account at your bank for your taxes. Then each time you receive a check from your clients, take 40 – 50% and deposit it into your tax account.

Why so much?

I'd rather hear about you having too much money at the end of the year in your tax account, than not enough. Be sure your tax account is an interest earning account. This way you're making money on your money before the IRS gets it.

Make it a habit and forget about the money in your tax account, at least until those quarterly payments are due. Then just write the check and forget about it.

Chapter 4.

Finding Projects

I hope you're finding this information valuable.

I recently embarked on a cold-calling campaign to see what works and what doesn't. I know many of us computer consultant types hate the marketing part of being a gainfully self-employed independent consultant, however, it's either marketing and promotions or the dreaded recruiters.

My cold-calling education dates back to the days before PC's. I used to sell office-equipment - typewriters, calculators and copiers. It was very competitive, but I loved the intensity. I participated in a sales training class where the instructor was a very honored salesman from way back. Since I was fairly new he picked on me for many of his "role" playing games.

We learned a canned script that went something like this:

Hello, My name is Tom Raef. I was wondering who is responsible for buying office equipment for your office?

Yada, yada, yada...

After rehearsing this a number of times he informs my peers that I will make a real cold-call using this technique! Whoa! I'm not ready for this.

We open up a directory, he dials a number and hands me the phone. I started this way:

Hello, I was wondering if my name is Tom Raef?

Well the entire group exploded into a teary-eyed laughter that I can still hear. I quickly hung up the phone and looked for the nearest rock to climb under.

The lesson I learned from this was, know what you're going to say before you pick up the phone. Preparation is the key to success.

Which leads me to this chapter.

During my recent cold-calling campaign, I targeted small companies in the northern suburbs of Chicago. Since I thought companies might be looking to migrate to Windows 2000 by now, that was my focus. First I called 100 companies and used this opening statement:

My name is Tom Raef and I'm a computer consultant. I'd like to know who I would talk to about migrating your computers to Windows 2000?

A little wordy, but direct.

I found 1 company that would talk to me. One! Out of 100 calls, one company would talk to me and that one was pretty much useless for business because they only had 3 PC's in their office. No servers. No needs. No nothing! Actually I think the person I talked with, was lonely and wanted to talk to anyone.

Then I waited two weeks and using the same list of companies, I changed my message:

Hello, my name is Tom Raef. I'm a computer consultant and I'd like to know what plans your company has for upgrading to Windows 2000?

Out of 100 calls, 98 of them said something along the lines of "hold on, let me transfer you to..."

My first batch of calls took me less than an hour and a half. This second batch took me almost 6 hours. Almost every company wanted to talk to me about migrating to Windows 2000. Well, not actually migrating, but upgrading.

What was different?

Before I go into that, let me explain that when cold-calling, less time is bad, more time is good. More time means you're getting through to people who are very likely prospects. Not all of them will become clients, but after talking with someone and they say they're not ready yet, ask when you could follow-up with them. Ask them if you could send them a newsletter about how others are using the new OS. Also, ask them who else they might know who might be looking to upgrade

their systems.

This is huge. You will be amazed at how many people aren't ready yet, but they know someone who is. When you do a good job for this referral, the original person will surely use you when they are ready.

Okay back to the differences between the two sessions...

In the first campaign, I asked a question they can easily answer with, "Sorry we're all set." And hang-up. When you ask an open-ended question, they feel more compelled to let you talk with someone who might know what you're talking about.

I'm asking the same question but with a tighter focus. I'm assuming that they do have plans for upgrading. Isn't everyone? Second, they know they probably don't have the answer, so they'll want to transfer the call to someone with authority. The other difference is, most non-computer people have no idea what a migration is, except for something birds do in the winter.

Use terms the everyday layperson can understand - to a point. Sometimes the confusion caused by speaking in "geek" gets you through to someone in the computer department.

Avoid using the "do you want a computer consultant" mentality. Ask them how they're using Outlook for better communications with their customers. Ask them, if they're using more than one computer system. Ask them, if they take orders on their web site from their customers. Ask them if they automatically notify their customers

of web site order status.

Ask them anything, just make it specific and make it something only somebody with authority might know the answer to. This will get you to talk with the right person.

When you use the "do you want a computer consultant" angle you're setting yourself up for failure. Let me explain.

When I was selling copiers a friend of mine named Bob was working with me. He used to go out and knock on more doors than anyone I ever knew. He was aggressive. He had one major fault - he couldn't get in to see people.

Marketing of any kind is a numbers game. After awhile you'll know you have to make X number of calls for each appointment and that each appointment will mean Y projects. As copier salesmen, we knew if we made a minimum of 30 cold calls a day we would sell one copier a week.

Bob's numbers for cold calls were always higher than everybody else's but his sales were always lower than everybody's. I sat down with him one day and we analyzed his techniques.

After only a few minutes, I realized what his problem was. His opening line was, "Hello my name is Bob and I'd like to talk to you about a new copier." He didn't qualify these people, he just assumed he was going to sell them a new copier.

His only success came as a result of actually finding someone who already knew they wanted a new copier. These people were few and far between.

I discussed value with him until he finally understood it. He then went on to become one of the best salesmen the company ever had.

That's the difference between value and price.

Don't send out letters or make phone calls asking people, "do you need a computer consultant?" You'll get more no's than you ever thought possible.

In closing this e-book, I would like to let you know about other e-books I've written.

If you go to my site www.consultantsadvocate.com you'll find two of my other e-books, "Consultant's Guide to *Becoming* Gainfully Self-Employed", which contains 375 pages of the marketing methods I use to remain gainfully self-employed, and "Consultant's Guide to *Being* Gainfully Self-Employed" covers incorporation, taxes in more detail, business insurance, accounting and retire planning in 284 pages.

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