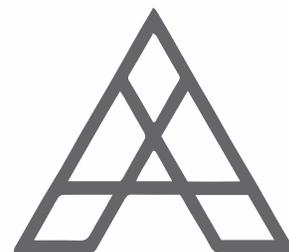


eBook

4 REASONS WHY SMART CONTRACTORS REFUSE TO TAKE DRAWS





INTRODUCTION

The Apparatus team has deep roots in the contracting and building industry. We know firsthand the dedication it takes to turn a professional dream – like running your own contracting business – into reality.

We also know how rewarding all that hard work is, and how important it is to stay focused and informed along the way. We strive to provide contractors like you, whether you're established or just starting out, the information that will help you start, grow and scale your business to its highest potential.

Our goal is to help you achieve your goals and inspire you to run your best business.

We hope this eBook offers you the insight you needed about payroll and causes you to investigate other areas of your business you'd like to improve.

We'd love to discuss how becoming a client of Apparatus can power your back office and unlock the potential in your contracting business.

We're standing by, whenever you're ready!

The Apparatus Team



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ONE

PAYROLL SATISFIES THE IRS

The IRS requires that all individuals pay federal taxes on their income every year, and each state that levies an income tax on its residents has similar requirements. If you have part-time or full-time workers who are not independent contractors and are being paid lump sum payments without withholding, the state and federal penalties to your business and to your workers can be substantial.

The IRS has a very clear set of tests it uses to determine whether a worker is an independent contractor, and most states have adopted the same set of tests to make that determination for workers in their states.

Many contracting companies employ workers who they pay as if these workers are independent contractors, but if that company's state or the IRS gets involved and questions the classification of these workers, the workers will fail the independent contractor test. (To know more about this IRS employee vs. independent contractor test, see our Blog post on that topic [here](#).)

The IRS and most states require the following information for each payment made to an employee:

- Name, address, and Social Security number of each employee
- Total amount and date of each payment of compensation
- Period of service covered by each payment of compensation
- Portion of each payment of compensation that constituted taxable wages
- Copies of each employee's withholding exemption certificate
- Dates and amounts of tax deposits you made
- Copies of returns you filed

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And remember, the IRS and your state get to determine whether your workers are independent contractors or are just employees posing as independent contractors. If you've been paying workers as independent contractors and your state or the IRS reclassify your workers as employees, not only will you face the paperwork required to provide all of the payment information for each employee, you and your employees will face substantial penalties and fees. You might even be held liable for state or federal withholding for these employees and forced to make those payments yourself.

What's the solution? We recommend using a regular payroll process as an industry best practice for *all* employees including you, the business owner. This is true whether your business is an LLC, a corporation, or a sole proprietorship.

First, be honest with yourself about the true status of the workers you employ, and if they are employees, get them set up to be paid like employees. Moving to a payroll system does not require that you change the amount of time your employees work – they can still be part time or full time – that is your choice. Just be sure to pay attention to break time and overtime requirements for hourly employees.

Next, set up a regular pattern of paychecks for yourself and for your employees, making sure you do proper state and federal withholding for each employee.

The benefits of this simple approach are substantial and immediate.

Under a regular payroll system, you and your employees will receive paychecks on a regular basis, with state and federal taxes *already* taken out. A payroll system accounts for state and federal tax withholdings automatically, so every check you issue will be post-tax. You'll still have complete control over the pay rates and frequency of pay for you and your team, and adjustments can be made at any time.

The best part? Tax season becomes a lot less scary when you've been tax compliant all year long.

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TWO

PAYROLL ELIMINATES PERSONAL DRAWS

Personal draws often are the norm for small contracting businesses. It's not due to poor business management or financial results, but really just a lack of information.

Many new contractors forget that they're actually employees of their company. As an owner, you'll tend to forego the idea of a regular paycheck and instead devote all your time and money *to the business*. While this says a lot for your dedication and determination, it leaves much to be desired when you realize that you have a mortgage payment to make and other personal bills to pay!

If you were working at a hardware shop full time and didn't receive a paycheck on a regular schedule, how would you get paid? You'd have to approach the store owner each time you needed to pay a bill, make the rent, or buy groceries. But how would the shop owner know how much he or she owes you? This could become really frustrating for both parties. Now imagine that you're both the shop owner *and* the employee and the problem can become even more complicated.

Enter the habit-forming Personal Draw. It always starts with good intentions: you need to cover a bill, pay your mortgage, make a payment on your vehicle, or address some other financial need.

However, unless you've been diligently tracking your project revenues, costs, and net income, you're really making an *educated guess* as to how much cash you can afford to pull out of the company checkbook. Often this guess is influenced by your *need*, which further muddies the waters. It's likely that like most contractors, you'll draw more when your company has more cash. By the time you realize you are using the advances from new customers to pay the material bill and subcontractors from your completed prior projects, it is too late and you're in serious cash trouble.

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Personal draws, which are justifiable in theory, create problems because they are irregular and have no connection to net income, only to cash flow. They are inconsistent in amount and frequency, which adds chaos to your bookkeeping efforts.

By moving to a regular paycheck for yourself, you get the benefits of consistent pay, consistent tax withholding, and smoothed-out cash demands on your business.

A steady paycheck allows you to live within your means and can largely eliminate the need for sporadic cash withdrawals from your company's cash drawer.



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THREE

PAYROLL PROTECTS YOUR ASSETS

Building on the prior point, there is another very important benefit that a regular payroll process will provide to you and your contracting business.

Smart, successful contractors completely remove the temptation to draw company money out of the business for personal use. Why is this so important? After all, you *are* the business owner, surely the line doesn't need to be so finely drawn? Well, it actually does.

A court of law has the right to strip your corporation or LLC of its ability to shield your personal assets if they discover you have routinely used business funds for personal use. If you ever find yourself in *any* dispute, this is bad news. Frequent personal draws or frequent personal purchases using the company ATM card or checkbook can completely discredit the separateness of your corporation or LLC from you as an individual, based on the theory that if you are not treating your corporation or LLC as an entity entirely separate from yourself, the courts won't either.

As the owner of an LLC or a corporation, here are the rules you should be operating by:

- Don't divert corporate or LLC assets for personal use
- Don't commingle personal assets with those of the corporation or LLC
- Maintain a separate bank account for the corporation or LLC
- Don't use the corporation or LLC to engage in illegal, fraudulent, or reckless acts

When the courts strike down the protections of your corporation or LLC, your personal assets are then available to be seized by creditors or others in the event of a judgement against you. It's called Piercing the Corporate Veil...the

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courts remove liability protection from your corporation or LLC. Once the veil is pierced, both your *business and personal assets* are on the table for grabs.

How to make sure this never happens?

Don't use your business account for personal use, promptly repay your business if you accidentally use the wrong account for a purchase, and establish a regular payroll system and stick with it.



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FOUR

PAYROLL SAVES TIME, MONEY, AND FOCUS

Apparatus is a big advocate for making things simple and routine in your contracting business. It's never too soon to be thinking about how every process in your contracting business can be simplified or set up to repeat automatically. Payroll is one of those processes! Payroll services are inexpensive, and you can explore options that include bookkeeping or other back office services along with payroll.

A good payroll system will:

- Keep track of employee hours
- Calculate employee wages
- Withhold state and federal taxes
- Print and deliver paychecks or make direct deposits
- Pay state and federal employer obligations
- Pay employee withholding to the state and federal government

Imagine having the above tasks above eliminated from your worries. Once you set up a payroll system for your company there's very little maintenance involved. Of course raises, new employees and employee terminations will require you to communicate with your payroll service provider, but otherwise things should run very smoothly.

Setting your company up on payroll really is an essential step as your company matures. Many contractors skip this step, and the consequences can be substantial. Personal draws, paying workers under the table, incorrectly reporting income, failing to file tax returns, and dealing with year-end tax bills are all avoidable by simply putting in place a good payroll system.

To put your contracting business on sustainable path to success, automate your payroll. You'll avoid a perpetual headache and set a strong foundation to allow your business to grow. The more stress you remove from your business,

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the more focus you'll have *for* your business. Focus will help you steer your business toward success!



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