What Does an Employee Cost Your Business

In recent columns, I have written about the impact of small businesses in the US economy and also addressed some related “hiring” options and issues. Last week’s column spurred an area CEO to ask me to address the costs of taking on a new employee. That is a good question for today’s column.

When you think about adding a new employee to your payroll, determine what the actual financial cost of doing so means to your business. This includes the dollars and cents over and above the basic wage or salary you agree to pay. There’s a rule of thumb that the cost is typically 1.25 to 1.4 times the salary, depending on certain variables. So, if you pay someone a salary of $35,000, your actual costs likely will range from $43,750 to $49,000. Some added employment costs are mandatory, while others are a little harder to pin down. Fortunately, there may be tax savings to offset some of the costs.

I want to give you some recent data on this topic. So, I gleaned several sources and found that the US Small Business Administration recently published a post by Barbara Weltman that does a good job of setting forth this topic. Weltman is an attorney, prolific author with such titles as J.K. Lasser’s Small Business Taxes, J.K. Lasser’s Guide to Self-Employment, and Smooth Failing as well as a trusted professional advocate for small businesses and entrepreneurs. Here is a digest of Weltman’s work.

Mandatory added costs of an employee: Hiring an employee means considerable payroll tax costs, including:

- Employer share of FICA (7.65% on compensation up to the annual wage base, which is $132,900 in 2019, plus 1.45% on compensation over the annual wage base).

- Federal unemployment tax (FUTA) of $42 per employee. The FUTA tax rate is 6%, but most employers can take a FUTA credit of 5.4%, resulting in a mere 0.6%.
• State unemployment tax, which varies with each state and your claims experience (the more claims made by former employees for unemployment benefits, the higher your state unemployment tax rate will be).

You can learn more about these costs from the IRS and the Minnesota state revenue department.

You also need to address insurance coverage for your employees. This includes:
• Workers’ compensation. Costs vary from state to state.
• Other insurance that may be needed for the work performed. For example, if you have a professional firm, you may want or be required to pay for professional liability coverage. Similarly, you may need to have a bond, a type of insurance, for an employee to protect a third party (your customer). For example, a bond may be needed for employees who clean homes so that homeowners’ valuables are protected from employees’ damage or theft.

Talk with your insurance agent to determine what coverage is needed.

While these mandatory added costs can mount up, there’s good news. The costs of payroll taxes and insurance are fully tax deductible.

Other costs of an employee: Think about employee benefits you may want or need to offer an employee. Under federal law, only large employers (those with 50 or more full-time and full-time equivalent employees) must offer health insurance or pay a penalty. However, there is a federal tax credit for small employers that choose to provide at least 50% of the cost of health coverage.

Offering retirement savings plans, such as 401(k) plans, to employees isn’t mandatory under federal law, but employers may choose to do so. The cost of employer contributions needs to be factored into the total wage package. Federal law requires employers with at least 50 employees to offer unpaid family and medical leave. But a number of states have paid leave laws. Some put the cost on employees (through wage withholding), while others require employers to share in the cost. And the District of Columbia puts the entire burden on employers.

These are only some of the employee benefits you can offer. You can learn more about tax deductibility as well as exemption from payroll taxes for various fringe benefits in IRS Publication 15-B.
In addition to fringe benefits, there is a slew of other employment-related costs that may be difficult to quantify. These include:

- The cost of recruitment, including background checks and drug testing where applicable.
- The cost of initial and ongoing training.
- Miscellaneous items, such as uniforms and protective gear where needed.

**Final thought:** Add up the costs to see whether your business can afford to add an employee to your staff. If your business is growing and you need more help, you can’t afford to NOT hire more workers. But knowing the cost will help you budget accordingly.

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