TaxSavers:

SELF-EMPLOYMENT

Tax Strategies for the Self-Employed

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Being self-employed can bring individuals great rewards and freedoms, yet it also brings great responsibility to ensure you comply with the rules and requirements of the IRS. This article discusses your income, allowable deductions and the tax regulations governing self-employed taxpayers.

Are You Self-employed?

You are considered self-employed and subject to self-employment tax laws if you:

- carry on you own trade or business
- have a profit motivation for your business activity
- operate your business in a regular manner
- are a sole proprietor
- are an independent contractor
- work full or part-time in the business endeavor
- have a net profit of $400.00 or more

Self-Employment Tax

All self-employed must pay a self-employment tax in addition to income tax. The tax is 15.3% of net earnings and is comprised of two components -- a 12.4% for Social Security tax and a 2.9% for Medicare tax.

The 12.4% portion is paid on net income (revenues less expenses) up to a set amount. For year 2016, the first $118,500 of your combined wages, tips, and net earnings are subject to any combination of the Social Security part of self-employment tax, Social Security tax. The amount increased to $127,200 for 2017.

The 2.9% Medicare tax is paid on all net income. All your combined wages, tips, and net earnings in the current year are subject to any combination of the 2.9% Medicare part of Self-Employment tax, Social Security tax.

If you receive any wage income on which Social Security tax was paid then the self-employment tax income maximum is reduced by the amount of wages received. If self-employment income is below $400 no self-employment tax is due.

Started from 2013, an additional Medicare tax rate of 0.9 percent went into effect and applies to wages, compensation, and self-employment income above a threshold amount received in taxable years beginning after Dec. 31, 2012.

What is Self-employment Income?

- Income received from a trade or business you conduct on a continuous and regular basis less allowable deductions
- Payments received from your partnership for services rendered
- Income paid by insurance companies to retired insurance agents based on prior work such as unpaid commissions
- Real estate rental income if substantial services are rendered
- Extended earnings payments to an independent insurance agent
- Income from independent contracting of services
- Income from selling and distributing newspapers and magazines

What is Not Self-employment Income?

- Income received as an employee of another company
- Income paid to your child if under 18 and your business is a sole proprietorship or partnership
- Dividends and interest
- Gain or loss from sale or exchange of capital assets or disposition of property not included as inventory or held for sale
- Incentive pay to sales people in a dealership (auto dealer) but paid by the manufacturer
- Earnings and dividends of an S Corporation provided shareholders take a reasonable salary

SELF-EMPLOYED TAX TRAPS

Each year the IRS publishes statistics on the types of returns that get audited and those returns with self-employment income are always at the top of the list.

To reduce your chances of an unexpected tax bill:

- Always keep self-employment activity and records separate from other expenses. Keep a separate checking and savings account for your self-employment activities. The IRS is very quick to deem expenses as personal (non-deductible) expenses if your bank account co-mingles expenses.
- Do not confuse hobby and rental income activity as self-employment activity. The tax code applies separate laws to these two activities. If in doubt…ask us.
- Remember the IRS treats all profits as if they are wages subject to Social Security and Medicare taxes (self-employment taxes). This is true whether you wish to distribute or retain your profits. Consider using alternative corporate structures if you want to avoid some of this tax.

Self-Employment Health Insurance

Another major tax deduction provided by the IRS to the self-employed is the ability to deduct a large portion of your medical insurance costs. Under certain circumstances, if you hire your spouse as a bonafide employee and provide health insurance, 100% of the cost of the insurance may be deductible.
Similarly, a written self-insured medical reimbursement plan may be a 100% deductible expense and enable you to provide tax free reimbursement of uninsured medical costs to employees for things like co-payments, prescriptions, vision and dental care.