



## Self-Employed

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.

### Are You Self-employed?

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

- carry on your 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 at least \$400.00 (or have a net profit of \$100.00 or more as an employee of a church electing exemption from Social Security Withholdings)

## 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 has two components; a 12.4% old age, survivors and disability insurance (OASDI) tax and a 2.9% component for hospital insurance (Medicare). The 12.4% OASDI portion is paid on net income (revenues less expenses) up to a set amount similar to social security. The 2.9% Medicare tax is paid on all net income. If you receive any wage income on which Social Security or Railroad Retirement taxes were 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.

### 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
- Minister's housing allowances unless Form 4361 is filed to opt out of Social Security (not subject to income tax)
- Income from a church or church-controlled organization
- Income from independent contracting of services
- Income from street hustling, panhandling, and drug dealing
- Income from commercial fishing if working for a share of the catch
- Foreign earned income excluded from income tax
- Income from selling/distributing newspapers and magazines
- Business interruption insurance payments
- Crop-sharing income

### What's 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
- Income for services not performed on a continuous or regular basis (this is deemed a hobby)

## Self-Employment Tax Traps

Each year the Treasury Department (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.
- 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.

## Deductions

One of the biggest tax advantages for self-employed is the ability to deduct your business expenses directly against your income—regardless of whether you itemize your deductions. You are not subject to the 2% of adjusted gross income threshold that applies to an employee's out-of-pocket business related expenses. As a self-employed individual, your business expenses reduce the amount of your income that is subject to the self-employment tax (FICA) while the unreimbursed business expenses of an employee do nothing to reduce their FICA tax.

### Self-employed 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.

### Domestic Production Activity Deduction (DPAD)

Beginning in 2005, there is a special deduction on page one of Form 1040 for qualified domestic production activities. The deduction is 6 to 9% of net qualified income (limited to 50% of W-2 wages). If you manufacture product, grow crops or process tangible personal property your business may qualify. Common businesses include: farming, ranches, film/music/software development construction engineering and architectural services.

## Self employment Income/Expense Tracking Worksheet

(Use the worksheet below to track your income and allowable expenses by quarter to assist in deriving your net earnings and estimated quarterly tax obligations)

	1 <sup>st</sup> Qtr.	2 <sup>nd</sup> Qtr.	3 <sup>rd</sup> Qtr.	4 <sup>th</sup> Qtr.	Total Year
<b>INCOME</b>					
Gross Receipts/Sales					
Returns & Allowances					
*Income Reported on 1099's					
*Commissions					
Other:					
Other:					
*Don't Duplicate if in Gross Receipts					
<b>TOTAL INCOME</b>					
<b>COST OF GOODS SOLD</b>					
Beginning Inventory					
less: Ending Inventory					
add: Purchases					
less: Personal Use Inv.					
-Cost of Labor					
-Materials/Supplies					
-Other:					
-Other:					
= TOTAL COGS					
<b>EXPENSES</b>					
Advertising					
Bad Debts (if reported as income)					
Bank Charges					
Cabs, Bus, Rentals					
Car/Truck Expense (Detail)					
Commissions & Fees Paid					
Depreciation (Attach Schedule)					
Dues & Publications					
Employee Benefit Programs					
Entertainment					
Freight (Not Included Above)					
Gifts					
Health Ins. (Personal 100%)					
Insurance (Business)					
Interest (Business)					
Laundry & Cleaning					
Local & Professional					

	1 <sup>st</sup> Qtr.	2 <sup>nd</sup> Qtr.	3 <sup>rd</sup> Qtr.	4 <sup>th</sup> Qtr.	Total Year
<i>(Expenses continued)</i>					
Lodging					
Meals & Entertain. (at 100%)					
Meals & Tips (at 100%)					
Mortgage Interest					
Office Supplies & Postage					
Parking Expense					
Payroll Taxes					
Pensions/Profit Sharing					
Rent (Business)					
Repairs & Maintenance					
Social Security and Medicare					
Supplies (Other)					
Taxes					
Tickets & Events					
Transportation (Air Fare)					
Travel (Out of Town)					
Telephone (Business)					
Unemployment (Fed & State)					
Utilities					
Wages (Not Reported Above)					
Other:					
Other:					
Other:					
<b>TOTAL EXPENSES</b>					
<b>NET INCOME *</b>					

\* (Income - COGS - Expenses)

### BUSINESS ACTIVITY

Check here if you believe this business activity qualifies for the DPAD.  
Note the percentage of the activity that qualifies \_\_\_\_\_%.

<b>AUTO MILEAGE</b> (Adequate records required)		
	2010	2011
Total Miles Driven		
Business Miles		
Personal Miles		

This publication provides only summary information regarding the subject matter. Please call with any questions on how this information may impact your situation.