



Tax Considerations for the Self-Employed

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Self-employment has its appeal, especially when businesses aren't creating jobs fast enough for the nation's unemployed.

A person who chooses this route might be a sole proprietor in a trade or business — for example, a plumber or cabinetmaker — or she might be an independent contractor, an insurance agent, limited liability corporation member or a partner in a business. These taxpayers are treated as independent contractors by the Internal Revenue Service and must be aware of the responsibilities and benefits of being self-employed. They will quickly become familiar with Schedule C – the IRS' self-employment form.

Anyone who pursues a trade or business to make a profit must file a Schedule C form along with the standard 1040 income tax form. The Schedule C (Profit or Loss From Business) summarizes gross income and profit, business expenses or deductions and net profit or loss.

There are tax advantages to being self-employed, but being one's own boss also means being responsible for accurately reporting all income. Sole proprietors who underreport income — intentionally or due to poor record keeping — face fines and penalties if an IRS audit determines that the filer committed fraud to evade taxes or failed to report all income because of an honest mistake. The IRS gives close scrutiny to Schedule C filers, and any taxpayer who files this form should keep careful records of all business-related transactions

All business income must be reported on Schedule C. In addition to income reported on 1099-Misc forms, all cash receipts or sales must also be included.

Expenses are also reported on Schedule C. Expenses must be in line with the industry in which the taxpayer works, and they must be legitimate. Most business expenses are 100 percent deductible. Fully deductible expenses include supplies, postage, advertising, repairs, contract labor and insurance costs.

Costs associated with business meals and entertainment are only partially deductible, and strict rules apply. Those who claim automobile expenses can report actual expenses or simply apply the standard IRS mileage rate. Self-employed people can deduct for depreciation of business property, but this, too, is subject to complicated rules and requires precise documentation.

If the self-employed person chooses to deduct the costs associated with using part of the home as an office or studio, he or she must file Form 8829 with the tax return. This deduction has tax repercussions when the home is sold, so the homeowner-proprietor should also consider this carefully before taking this deduction.

Once the filer has calculated all income and deductions, the next step is determined by whether he has made money or lost money. If the net profit exceeds \$400, most Schedule C filers must submit a Schedule SE to pay their share of Social Security and Medicare taxes.

The Small Business Development Centers provide workshops about self-employment and Schedule C. A tax professional should be contacted for more detailed information. Only attorneys, CPAs and EAs – tax practitioners known as enrolled agents who are authorized by the U.S. Department of the Treasury – may represent taxpayers before the IRS.

Visit www.nmsbdc.org to find business-tax workshops.

Finance New Mexico is an initiative of the New Mexico Small Business Investment Corporation (NMSBIC) and its partners to assist individuals and businesses in obtaining skills and funding-resources for their business or idea. To learn more, go to www.FinanceNewMexico.org.

