

Independent Contractor Taxes...

Know Your Options



Makara & Associates_{LLC}
Certified Public Accountants and Consultants



A Free eBook Provided By:

Mark Makara, CPA

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1. Determine Your Independent Contractor Status



First as I mentioned above I'm assuming you have already determined you are an independent contractor based on the rules set out by the Internal Revenue Service, see [IRS.gov webpage](https://www.irs.gov)" for further details.

The Internal Revenue service has boiled down the old 20 factor test to three categories:

- 1.) **Behavioral Test** – Focuses on whether the company controls or has the right to control when, where, and how the job is completed.
- 2.) **Financial Test** – Who controls the economics of the workers job? Is the individual reimbursed for travel? Who provides the job related tools or supplies? Is the individual paid by the hour or a single payment after completion of the job? Can/does the individual work for more than one company, with the ability to make a profit or suffer a loss?
- 3.) **Type of Relationship Test** – How do each perceive the business relationship? Is the worker rendering services indefinitely or on a project to project basis? A written contract to be an independent contractor is not the end all be all, the IRS does not follow these agreements if the above tests prove differently.

2. Contact a Tax and/or Legal Professional

The balance of this eBook is not intended to cover every situation. Once you determine that you are self-employed and will receive a 1099 for your services I suggest you contact a tax and/or legal professional to guide you through your individual situation.

Whether you're a consultant, hair stylist, or painter, being self-employed is the same as starting any other business and you need to treat it accordingly. You may or may not have employees or a brick and mortar office location; however you need to treat your business in the same manner as a building contractor with 25 employees would. As I will explain in detail below, following corporate procedures will benefit you each year as your business continues to grow.

Schedule C (Form 1040), Corporation (Form 1120 S or C), Limited Liability Company or Partnership (Form 1065) If you make no decision regarding the above and fill out a **W-9** with your social security number on it you have decided, by default, to file your income and expenses as a self-employed individual on your personal income tax return (**Schedule-C of Form 1040**).

Not that this is a problem, however entity selection can have different outcomes when it comes to taxes paid and benefits available to you the owner and any employees. This decision, in my opinion, is driven by a number of factors that should be discussed with tax and/or legal professionals. These factors include if you will have any partners? What taxable income is expected in the first couple of years? What legal liability concerns arise with the type of business you are engaged in?

3. Set Up a Separate Business Bank Account

Setting up a separate bank account is a must, be aware to avoid depositing income earned and paying expenses out of your personal checking account.



Two problems here:

1st - if you're ever in a legal claim that bank account could be included in the case along with all those transactions that you may or may not want to be public knowledge.

2nd - as a tax professional the last thing we want to see is you showing up at our office with 10 out-of-the 12 months bank statements and a bag of receipts.

Setting up accounting software is pretty simple these days. Complete a monthly bank reconciliation categorizing/grouping expenses the best you can.

Again, as a tax professional, you want me to save you tax dollars not recreate your accounting records, in some cases that happened 15 – 18 months ago. Will you remember what happened 15 months ago? I will not have any idea.

Having organized records will not only save you tax preparation fees it will also help if you are selected for an IRS audit, tied out well-organized records go a long way with an auditor. Demonstrates that you are running a corporate like business not a hap hazard organization they need to check on for comingled personal and business transactions. I also suggest using one credit card for your business; same issues can come up as with a comingled bank account.

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4. Know Your Business Expenses

See my eBook [“7 Things Every Small Business Owner Needs to Know”](#) for additional information on expenses. I will review below a few expense categories and taxes that I believe are common with self-employed individuals.

Ordinary business expenses including rent for an office, utilities for said office, supplies and equipment needed to run the business are deductible 100% against income earned. I’m not going to go into much detail here because if used only for the generation of the income it’s considered an ordinary expense.



If you are filing a Schedule-C on your personal form 1040 estimated taxes are due on a quarterly basis:

- ★ **April 15**
- ★ **June 15**
- ★ **September 15**
- ★ **January 15** (of the following year).

If you have always had a **W-2** with taxes withheld from your earnings, this area will be where you get yourself in trouble. When **you are an employee the following are deducted from your payroll check each pay period:**

- ★ **Social Security (6.2%)**
- ★ **Medicare (1.45%)**
- ★ **Federal withholding (based on your W-4)**
- ★ **State tax (if applicable) are deducted from your payroll check each pay period.**

As a self-employed individual you are responsible for the payment of these taxes, not only your portion but also the employer's match of:

★ Social Security (6.2%)

★ Medicare (1.45%)

tax which is an additional 7.65%. Therefore each dollar that is considered taxable income (after expenses) will first be taxed at 15.3% (Social Security and Medicare) Self-Employment tax, plus any income tax that is due on your personal tax return, form 1040.

As you can see depending on your personal situation, tax due from being an independent contractor can add up very quickly. The sooner you have a tax professional review your individual situation the less painful it will be when it comes time to file that first return after becoming a self-employed individual.

If you employ any individuals that should be paid as employees, the same rules will apply to your business when it comes to independent contractor's vs employee decisions. If it is determined you will pay individuals as an employee, have a payroll service prepare the payroll checks and quarterly filings.

In my 20 plus years of helping small businesses, preparation of payroll and paying/filing of quarterly taxes and forms is where business owners predominately get into trouble. The penalties alone for making the wrong deposit can quickly add up to an additional 25% of the amount owed. Payroll services are cheap compared to the problems that most likely occur if you try and do payroll yourself.

If it is determined that the individual will be treated as a sub-contract/independent contractor before issuing the first check get a signed W-9 to cover yourself when it comes time to issue 1099's at year-end. Penalties for not issuing 1099's when they are required can be up to 50% of the amount paid to the individual that the 1099 was not issued.

Have Questions, Need Answers?
Contact Makara & Associates Today!

5. Know Your Business Deductions

Home office deduction is another area that has changed recently. The Internal Revenue Service has provided a \$5 per square foot (max \$1,500) standard deduction for individuals that qualify. The rules to qualify for a deduction have not changed and you should review your situation with a tax professional before taking any deduction as it relates to a home office.



If you use your personal vehicle to travel to/from client(s) sites or run errands for business purposes you have **2 options for expensing the cost**.

1st - you can take a standard mileage deduction (.55 cents per mile in 2014) for each mile traveled for business.

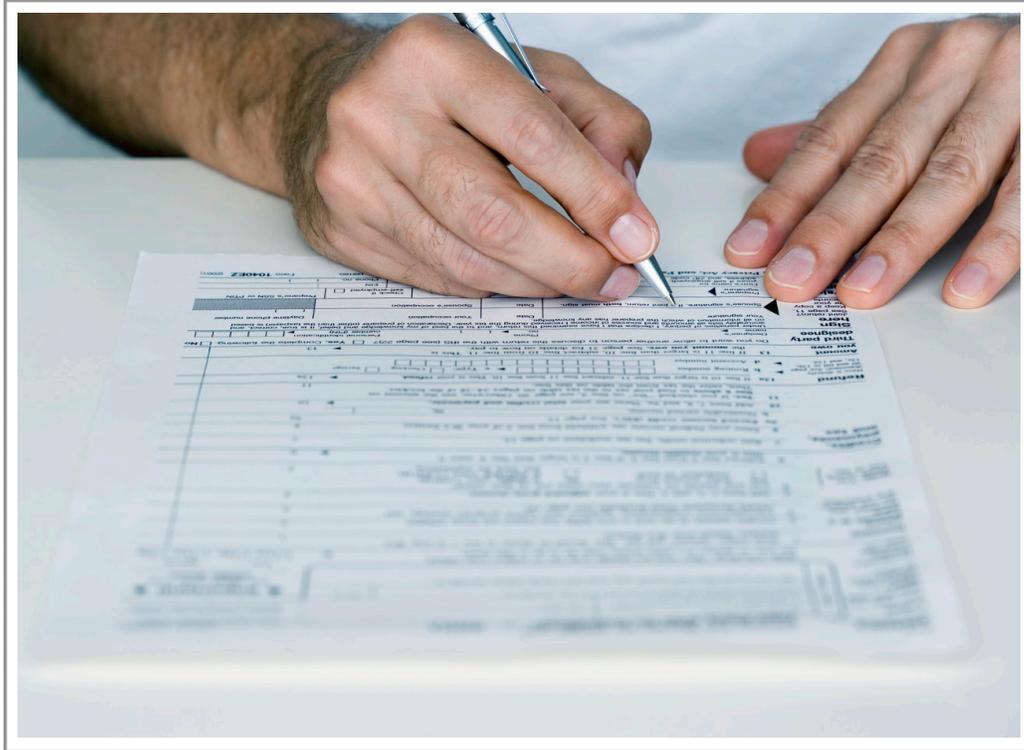
2nd - you can take actual expenses for the vehicle.

In either case a detailed mileage log is required to substantiate the deduction. My suggestion is to use the standard mileage option for at least the first year or until you get a tax professional to review your situation as deducting actual expenses comes with rules regarding personal use of the same vehicle.

Retirement plans are outside the scope of this EBook but be aware there are options out there as cash flow becomes available.

6. Filing Tax Returns as Independent Contractor

Being self-employed or classified as an independent contractor is not something to be taken lightly. There are many options and pitfalls out there that can a benefit to you and/or trip you up if not planned for correctly.



Seek out a tax professional sooner rather than later, I have had to explain too many taxpayers why they owe thousands of dollars in tax, when in the past they have received thousands of dollars in tax refunds.

I hope this eBook has provided you with a sample of what I think are the problem areas you will encounter in the first year of filing tax returns as an independent contractor.

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