

TAX

A HANDY GUIDE FOR:

FREELANCE TAXES

HELL(N)O

Hello freelancers,

Taxes are never fun.

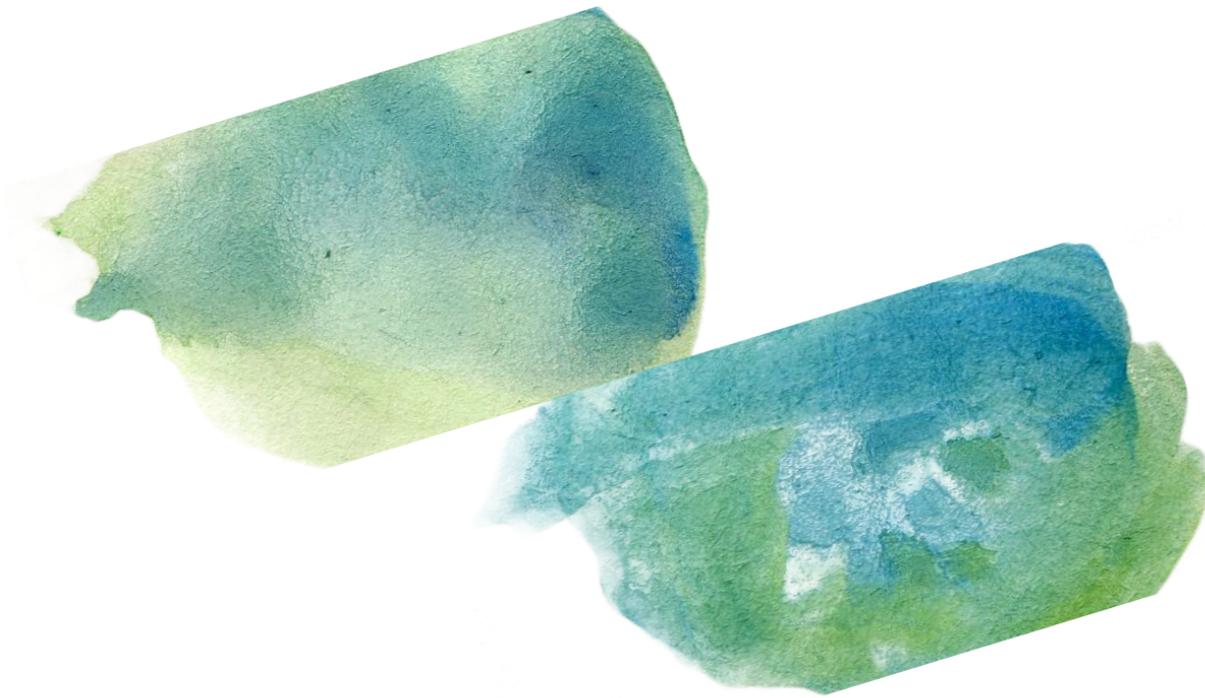
And if you're a freelancer or entrepreneur, things get even more complicated. There's self-employment taxes, business expenses, and accounting to think about. It can be a little confusing, and even overwhelming.

Don't worry. Once you understand the basics, and become familiar with a few best practices, it's not so bad. You'll probably even save a little money — and who doesn't like that?

Now, I'll be honest. I've been freelancing for over ten years, and I'm still trying to improve my workflow when it comes to accounting and taxes. It seems like there's always more to learn in freelance land.

Still, things have come a long way since I made my first spreadsheet and sent my first invoice. There's a lot of new tools and systems out there that can make things a whole lot easier. There's more info available than ever before to help guide you, and we hope this

quick guide will get you started on the right track. So: let's go over some tax basics that every freelancer should know.



W-2 vs. 1099

Battle of the tax forms

We'll start at the beginning: the paperwork you fill out when onboarding with a new client. While staffed employees fill out a W-2 tax form, that's not the case for us. As an independent contractor, we get a 1099 instead. So, what's the difference?

W-2 Form

22222		a Employee's social security number		OMB No. 1545-0008				
b Employer identification number (EIN)			1 Wages, tips, other compensation		2 Federal income tax withheld			
c Employer's name, address, and ZIP code			3 Social security wages		4 Social security tax withheld			
			5 Medicare wages and tips		6 Medicare tax withheld			
			7 Social security tips		8 Allocated tips			
d Control number			9 Verification code		10 Dependent care benefits			
e Employee's first name and initial		Last name		Suff.		11 Nonqualified plans		12a
f Employee's address and ZIP code		13 Statutory employee <input type="checkbox"/>		Retirement plan <input type="checkbox"/>		Third-party sick pay <input type="checkbox"/>		12b
								12c
								12d
15 State	Employer's state ID number		16 State wages, tips, etc.	17 State income tax	18 Local wages, tips, etc.	19 Local income tax	20 Locality name	

Form **W-2** Wage and Tax Statement
 Copy 1—For State, City, or Local Tax Department

2017

Department of the Treasury—Internal Revenue Service

If you've ever been a full-time or part-time employee at a company, you've filled out a W-2 form.

In this situation, I have to say: taxes are simpler. Money is automatically withheld from each paycheck and set aside for tax purposes. Not only that, but your employer actually pays half of your Social Security and Medicare contributions (ka-ching!). All you have to worry about is filing your personal income taxes each April.

But we're not here because we want to be salaried employees, are we? We're here because we want to break out into the wild world of freelancing and entrepreneurship. It's exciting, sure, but it's also a little more complicated when it comes to taxes.

1099 Form

CORRECTED (if checked)

PAYER'S name, street address, city or town, state or province, country, ZIP or foreign postal code, and telephone no.		1 Rents	OMB No. 1545-0115	<div style="font-size: 2em; font-weight: bold;">2018</div>	Miscellaneous Income
		2 Royalties	Form 1099-MISC		
PAYER'S TIN RECIPIENT'S TIN		3 Other income	4 Federal income tax withheld	Copy B For Recipient	
		5 Fishing boat proceeds	6 Medical and health care payments		
RECIPIENT'S name Street address (including apt. no.) City or town, state or province, country, and ZIP or foreign postal code		7 Nonemployee compensation	8 Substitute payments in lieu of dividends or interest	This is important tax information and is being furnished to the IRS. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this income is taxable and the IRS determines that it has not been reported.	
		9 Payer made direct sales of \$5,000 or more of consumer products to a buyer (recipient) for resale <input type="checkbox"/>	10 Crop insurance proceeds		
11	12				
Account number (see instructions)	FATCA filing requirement <input type="checkbox"/>	13 Excess golden parachute payments	14 Gross proceeds paid to an attorney		
15a Section 409A deferrals	15b Section 409A income	16 State tax withheld	17 State/Payer's state no.	18 State income	
\$	\$	\$	\$	\$	

Form **1099-MISC** (keep for your records) www.irs.gov/Form1099MISC Department of the Treasury - Internal Revenue Service

When you take on an assignment as an independent contractor that pays \$600 or more, you'll need to fill out a 1099.

First of all, remember: when you work for yourself, you're a business. You may be a company of one, but you're a company nonetheless. And as a solo operation, you act as both the employer and the employee. That means there's only one person around to withhold the money for all those various government taxes and contributions: you. And you need to make sure you pay those taxes on time.

Speaking of payments, there's two things to keep in mind when you make the move to 1099. First: in addition to personal income tax, you're required to pay self-employment tax. Second: you'll most likely need to start making [quarterly estimated payments](#).

Before your head starts spinning, let's stop and break these all down.

Self-Employment Tax

Taxes on taxes on taxes

As a freelancer, you still need to pay your usual personal income taxes. However, in addition to that, you need to pay a little something called self-employment tax. This covers two things:

1. Social Security Tax
2. Medicare Tax

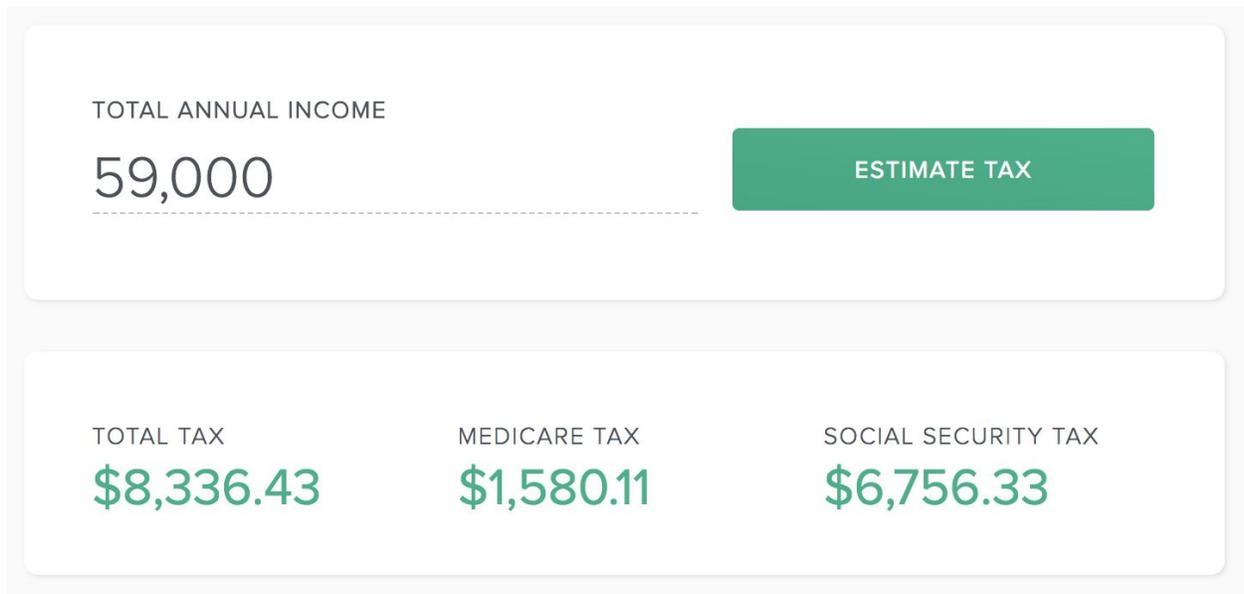
As we went over earlier, if you're an employee you typically don't have to worry about these things. Your employer sets the money aside on every paycheck, and then you settle up at the end of the year. But now things like Social Security and Medicare taxes are entirely your responsibility to track and pay. Ah, the double-edged sword of freedom.

You may say: wait! I only freelance part-time. I still have a full-time job! Does this still apply to me?

The answer is: yeah, probably. If you make more than \$400 a year as a freelancer, you're subject to self-employment tax — but only for your self-employed income (money via 1099, not W-2).

Remember: this is in addition to, and completely separate from, your personal income tax.

Just how much will you owe, exactly? Well, it varies, and it might be worth your while to find a CPA who specializes in freelancers. They can help guide you through your specific situation better than I can! Better safe than sorry, friends.



The image shows a screenshot of a tax calculator interface. The top section displays 'TOTAL ANNUAL INCOME' as '59,000' with a dashed line underneath. To the right is a green button labeled 'ESTIMATE TAX'. The bottom section displays three tax categories: 'TOTAL TAX' at '\$8,336.43', 'MEDICARE TAX' at '\$1,580.11', and 'SOCIAL SECURITY TAX' at '\$6,756.33'. All monetary values are in green.

Category	Amount
TOTAL ANNUAL INCOME	59,000
TOTAL TAX	\$8,336.43
MEDICARE TAX	\$1,580.11
SOCIAL SECURITY TAX	\$6,756.33

Example of estimated taxes using [Bonsai's calculator](#)

Should I be paying taxes as a Freelancer?

The Internal Revenue Service requires that all freelance income above \$400 a year be reported, and that profit from income made as a freelance (or independent contractor) be subject to the appropriate tax rate. This means that you should count earned income in the form of cash, check, PayPal payments, or other methods of compensation and include it on your schedule C form. It doesn't matter if you received a notification or

statement of earnings from a company documenting your pay; not all earnings will trigger a tax form, so you need to be tracking all earnings on your own.

“Freelancers should automatically set aside one third of their paycheck into a savings account to cover their estimated federal, self-employment, and state income taxes liability, and then make timely quarterly online payments through the IRS and their state's payment processing portals to avoid the late payment penalty and interest fee.”

*Argel Sabillo, CPA
Co-founder & CEO of [Levee](#)*

What you pay taxes on, however, will depend on the formula of business earnings minus business expenses (which gets you to your magical “profit” number.) You will only be taxed on that profit. It’s also wise to know what your tax liability is each year, and see if you may be required to make estimated quarterly tax payments. Generally, if you don’t think you’ll owe more than \$1,000 in taxes – after subtracting federal income taxes – you probably won’t need to make quarterly payments.

What’s the Self-Employment Tax?

This is the tax amount paid on earnings from a sole proprietorship or partnership business that goes to Medicare and Social Security; it is also referred to as SECA. Since you are your own employer, you do not have a boss to take out (or withhold) this money from your check, so you must pay it yourself at tax time. You also pay at a higher rate

than a traditionally-employed person, because you have no employer to pay part of the taxes for you.

How is the Self-Employment Tax Calculated?

The Self-Employment tax is calculated on 92.35% of your total income. This rate is derived from the fact that self-employed taxpayers can deduct the employer's portion of the tax, which is 7.65%.

The tax rate is currently 15.3% of your income, with 12.4% going to Social Security and 2.9% going to Medicare. The Social Security portion has a limit on how much of your income is taxed (currently \$127,200 or less), whereas the Medicare portion does not. You must pay this tax if you've made money from your freelance business of \$400 or more.

What's the Medicare Tax?

This portion of the tax freelancers pay goes to fund the federal government's Medicare program. It is used to provide subsidized health care and programs to retired Americans and to disabled individuals. Money from the Medicare program also subsidizes hospital insurance benefits. So, when you pay your self-employment tax, less than 3% of that money is going to this program.

What's the Social Security Tax?

Similar to the Medicare Tax, this is a portion of your self-employed tax that supports another government program – specifically, the Social Security program. Social Security is known for the cash benefits it provides to seniors, but it also plays a role in supporting the disabled and surviving spouses and children. One important thing to note is that Social Security Retirement Benefits are based on your highest 35 years of earnings in a

lifetime. Your freelance income is counted into this formula; the more you make and report as a freelancer, the closer you'll be to maxing out Social Security retirement benefits later in life!

Should I be paying Income Taxes on top of my Freelance Tax?

Yes. It's very important to understand that you will always pay Self-employment taxes (those that contribute to the Social Security and Medicare programs) as long as you make more than \$400 in a given tax year. You may also pay income taxes, which are figured out differently for different earning brackets. Since you will pay both income and self-employment taxes on profit made from your freelance business, it is beneficial to try to claim every legitimate business-related expense you can.

One other important rule of thumb is this: While those working for an employer can avoid even filing taxes if they make below the filing threshold, this is because they have money withheld from their paycheck to cover the Social Security and Medicare taxes (referred to as "FICA" when paid through your employer.) Since freelancers really have no easy way to withhold these taxes, they must pay them at the end of the year on a tax return, even if they made very little. Remember, anything earned over \$400 will require you to file and pay the self-employment taxes -- regardless of whether you'll owe actual income tax.

Now, let's move on to the next thing you should put on your radar: quarterly estimated taxes.



Quarterly Estimated Taxes

New calendar alert!

If your freelance work generates a substantial portion of your income, the way you pay your taxes will change. Instead of punching in just once a year, you'll need to make estimated payments every quarter.

Hang in there. You've got this.

Yes, estimating your taxes can be a little tricky sometimes, but you just have to do your best. In fact, the IRS provides a worksheet to help you figure it out, which you can find on their website: Form 1040, Schedule SE.

Here's the basic rundown on this form. You'll be filling it out based on an estimate of your current income. A good starting point is to use your tax return from last year. Take a look at how much you previously paid in taxes, as well as any credits or deductions you logged.

So: keep good records! By comparing last year's numbers to this year's numbers, you should be more or less on track. Use the worksheets on Form 1040, Schedule SE, and pay what seems about right. Then, at the end of the year, you'll figure out if you over-paid

or under-paid (kind of like you've always done with your personal income taxes). If you paid too much, the overage will simply be applied to your taxes next year.

You can also enroll in The Electronic Federal Tax Payment System (EFTPS). This allows you to pay your estimated quarterly taxes electronically through the magic of the world wide web, directly from your bank account.

No matter how you go about it, start setting aside a portion of each paycheck to cover your self-employment taxes. If you don't meet your quarterly payments, you could be subject to penalties and interest!

Track Your Revenue and Expenses

Time to get organized

Self-employment taxes are not based on your gross income, but on your net profit. That's why it's crucial to keep track of how much you spend on business-related expenses. If you don't, you might miss out on all sorts of deductions. And those deductions could dramatically lower how much tax you owe.

It's best to start right away. Keep your records updated throughout the year, rather than scrambling to calculate everything last-minute when a payment is due. You've got enough to worry about when you're running your own business, so give yourself a break and keep those books tidy.

“Make sure you keep track of your receipts and expenses on the regular. There's nothing more headache-inducing than waiting until the 11th hour to get your expenses in order. Plus, it will just lead to a greater chance for error.”

Jackie Lam, personal finance writer

Blogger at HeyFreelancer.com

Using a cloud-based system like [Bonsai](#) can help to automate the process and keep you organized. This saves you not only a whole bunch of time, but also a whole bunch of headaches. No one likes searching through a mountain of old receipts and scattered

invoices. If you put a system in place early, then when tax time comes around, you'll have all your information ready to go.

Personally, I make it a point to balance all my numbers once a week, usually on Friday when I'm winding down and almost ready to hit up happy hour. However, you can use apps to link your bank and debit card transactions to your accounting system, rather than entering every single number by hand. It's all about finding a system that works for you — and then sticking to it consistently.



Business vs. Personal Expenses

Deductions are your friends

So, what qualifies as a business expense? Well, it really depends on what you do and how you work.

Everything from software to staplers might be on the list if they're key to running your business. These days, we freelancers use a lot of digital tools to get our work done, so these are also something to track. Whether it's design software, project management platforms, or just a basic website, don't take any of this for granted.

As independent workers, we don't get the perk of a shiny benefits package. Because of that, health insurance premiums can also be included as part of your business expenses. Even certain vehicle-related costs can count.

Do you work from home? You might be able to deduct part of your rent. I have a section of my home that is 100% set aside for work, including a dedicated desk that I only use when I'm on the freelance clock. The square footage of that particular area gets deducted.

"One thing freelancers should do better is to separate personal and business money. A. It's easier to track, and nothing slips through the cracks, and B. It takes less time to deal with, so you can spend more time earning money."

Eric J. Nisall, Freelancer Tax Expert
ericnisall.com

Some items, of course, fall into a bit of a gray area. For instance, you very likely have a computer that you use for both business and personal needs (I know I do). It just makes more sense, most of the time, than having two separate machines. In that case, figure out what percentage of the time you use your computer for work, and what percentage you use it for your personal life. The business portion of the cost can be considered a deductible expense.

Conclusion

Here's the thing: everyone's taxes and expenses will be different, and there's no one golden rule book on how to make it all work. It's one of the things that's been most challenging about being a full-time freelancer. While I may feel confident in my craft, it's taken time to learn how to run a business. That's a completely separate skillset.

As I said, it can get a little complicated at times, and you may want to pull in some professional assistance. Ideally, consult with an accountant who specializes in freelancers so they can give you guidance that's hand-tailored to what you do.

No matter how you go about things, make sure you have a reliable system that keeps you anchored throughout the year. Trust me, you'll be glad you did. By getting your books straight now, you'll avoid potential messes later on. If you think freelance taxes are complicated, just imagine dealing with an audit.

Let's be honest: doing your taxes will probably never be fun. I know it never is for me. But with a basic understanding of best practices, and the right tools under your belt, getting prepared is a whole lot easier.

And that means you can run off to happy hour a whole lot sooner.

References

Quarterly estimated tax dates

- April 15: For income received from January 1 to March 31.
- June 15: For income received from April 1 to May 31.
- September 15: For income received from June 1 to August 31.
- January 15: For income received from September 1 to December 31.

Common business expenses

- Website domain and hosting
- Software, apps, and online services
- Business cards
- Office supplies
- Business meals
- Phone and internet service
- Online classes
- Accounting service
- Vehicle expenses
- Health insurance
- Travel
- Postage

- Computers, laptops, and tablets
- Home office space
- Membership dues
- Legal services
- Payment transaction fees
- Retirement plan contributions
- Events and conferences
- Tax preparation

How to get started

- Download form 1040-ES to estimate your quarterly taxes.
- Enroll in EFTPS with the IRS to make online payments.
- Meet with a CPA to discuss your business.
- Use a system like Bonsai to track revenue and expenses.
- Get in the habit of logging your deductions now.