

Abstract: Today's technology makes self-employment easier than ever. But the self-employed face some distinctive challenges when it comes to their taxes. This article suggests some important steps to take, including learning about liability and claiming the home office deduction.

Facing the tax challenges of self-employment

Today's technology makes self-employment easier than ever. But if you work for yourself, you'll face some distinctive challenges when it comes to your taxes. Here are some important steps to take:

Learn your liability. Self-employed individuals are liable for self-employment tax, which means they must pay both the *employee* and *employer* portions of FICA taxes. The good news is that you may deduct the *employer* portion of these taxes. Plus, you might be able to make significantly larger retirement contributions than you would as an employee.

However, you'll likely be required to make quarterly estimated tax payments, because income taxes aren't withheld from your self-employment income as they are from wages. If you fail to fully make these payments, you could face an unexpectedly high tax bill and underpayment penalties.

Distinguish what's deductible. Under IRS rules, deductible business expenses for the self-employed must be "ordinary" and "necessary." Basically, these are costs that are commonly incurred by businesses similar to yours and readily justifiable as needed to run your operations.

The tax agency stipulates, "An expense does not have to be indispensable to be considered necessary." But pushing this grey area too far can trigger an audit. Common examples of deductible business expenses for the self-employed include licenses, accounting fees, equipment, supplies, legal expenses and business-related software.

Don't forget your home office! You may deduct many direct expenses (such as business-only phone and data lines, as well as office supplies) and indirect expenses (such as real estate taxes and maintenance) associated with your home office. The tax break for indirect expenses is based on just how much of your home is used for business purposes, which you can generally determine by either measuring the square footage of your workspace as a percentage of the home's total area or using a fraction based on the number of rooms.

The IRS typically looks at two questions to determine whether a taxpayer qualifies for the home office deduction:

1. Is the specific area of the home that's used for business purposes used *only* for business purposes, not personal ones?
2. Is the space used regularly and continuously for business?

If you can answer in the affirmative to these questions, you'll likely qualify. But please contact our firm for specific assistance with the home office deduction or any other aspect of filing your taxes as a self-employed individual.

© 2017