

If You Are Self-Employed



Most people who pay into Social Security work for an employer. Their employer deducts Social Security taxes from their paycheck, matches that contribution and sends taxes to the Internal Revenue Service (IRS) and reports wages to Social Security. But self-employed people must report their earnings and pay their taxes directly to IRS.

You are self-employed if you operate a trade, business or profession, either by yourself or as a partner. You report your earnings for Social Security when you file your federal income tax return. If your net earnings are \$400 or more in a year, you must report your earnings on Schedule SE in addition to the other tax forms you must file.

Paying Social Security and Medicare taxes

The Social Security tax rate for 2004 is 15.3 percent on self-employment income up to \$87,900. If your net earnings exceed \$87,900, you continue to pay only the Medicare portion of the Social Security tax, which is 2.9 percent, on the rest of your earnings.

There are two income tax deductions that reduce your taxes.

First, your net earnings from self-employment are reduced by half of your total Social Security tax. This is similar to the way employees are treated under the tax laws, because the employer's share of the Social Security tax is not considered wages to the employee.

Second, you can deduct half of your Social Security tax on IRS Form 1040. But the deduction must be taken from your gross income in determining your adjusted gross income. It cannot be an itemized deduction and must not be listed on your Schedule C.

If you have wages as well as self-employment earnings, the tax on your wages is

paid first. But this rule is important only if your total earnings are more than \$87,900. For example, if you had \$20,000 in wages and \$30,000 in self-employment income in 2003, you pay the appropriate Social Security taxes on both your wages and business earnings. However, in 2004, if your wages are \$70,000 and you have \$20,000 in net earnings from a business, you do not pay dual Social Security taxes on earnings more than \$87,900. Your employer will withhold 7.65 percent in Social Security and Medicare taxes on your \$70,000 in earnings. You must pay 15.3 percent in Social Security and Medicare taxes on your first \$17,900 in self-employment earnings and 2.9 percent in Medicare tax on the remaining \$2,100 in earnings.

Work credits

You need to have worked and paid Social Security taxes for a certain length of time to get Social Security benefits. The amount of time you need to work depends on your date of birth, but no one needs more than 10 years of work (40 credits).

In 2004, if your net earnings are \$3,600 or more, you earn the yearly maximum of four credits—one credit for each \$900 of earnings during the year. If your net earnings are less than \$3,600, you still may earn credit by using the optional method described later in this fact sheet.

All of your earnings covered by Social Security are used to figure your Social Security benefit. So, it is important that you report all earnings up to the maximum, as required by law.

Figuring your net earnings

Net earnings for Social Security are your gross earnings from your trade or business, minus your allowable business deductions and depreciation.

(over)

Some income does not count for Social Security and should not be included in figuring your net earnings:

- Dividends from shares of stock and interest on bonds, unless you receive them as a dealer in stocks and securities;
- Interest from loans, unless your business is lending money;
- Rentals from real estate, unless you are a real estate dealer or regularly provide services mostly for the convenience of the occupant; or
- Income received from a limited partnership.

Optional method

If your actual net earnings are less than \$400, your earnings can still count for Social Security under an optional method of reporting. The optional method can be used if your gross earnings are \$600 or more or when your profit is less than \$1,600.

You can use the optional method only five times in your life. Your actual net must have been \$400 or more in at least two of the last three years, and your net earnings must be less than two-thirds of your gross income.

Here is how it works:

- If your gross income from self-employment is between \$600 and \$2,400, you may report two-thirds of your gross or your actual net earnings; or
- If your gross income is \$2,400 (or more) and the actual net earnings are \$1,600 (or less), you may report either \$1,600 or your actual net earnings.

Special note for farmers: If you are a farmer, you can use the optional reporting method every year. It is not necessary to have had actual net earnings of at least \$400 in a preceding year. We suggest you call us and ask for the publication, *A Guide For Farmers, Growers And Crew Leaders* (Publication No. 05-10025).

How to report earnings

You must complete the following federal tax forms by April 15 after any year in which you have net earnings of \$400 or more:

- Form 1040 (*U.S. Individual Income Tax Return*);
- Schedule C (*Profit or Loss from Business*) or Schedule F (*Profit or Loss from Farming*) as appropriate; and
- Schedule SE (*Self-Employment Tax*).

You can get these forms from IRS and most banks and post offices. Send the tax return and schedules along with your self-employment tax to IRS.

Even if you do not owe any income tax, you must complete Form 1040 and Schedule SE to pay self-employment Social Security tax. This is true even if you already get Social Security benefits.

Family business arrangements

Family members may operate a business together. For example, a husband and a wife may be partners or run a joint venture. If you operate a business together as partners, you should each report your share of the business profits as net earnings on separate self-employment returns (Schedule SE), even if you file a joint income tax return. The partners must decide the amount of net earnings each should report (for example 50 percent and 50 percent).

Contacting Social Security

For more information, visit our website at www.socialsecurity.gov or call toll-free **1-800-772-1213** (for the deaf or hard of hearing, call our TTY number, **1-800-325-0778**). We can answer specific questions and provide information by automated phone service 24 hours a day.

We treat all calls confidentially. We also want to make sure you receive accurate and courteous service. That is why we have a second Social Security representative monitor some telephone calls.