

# How to Report and Pay Independent Contractor Taxes

Answers to Your Questions about Taxes as an Independent Contractor

By Jean Murray

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Being self-employed often means being an independent contractor – that is, an independent business person. It's really just another way of getting paid for your work. If you have been an employee and you're now self-employed as an independent contractor, you'll find that taxes are different.

In this article, you'll find out about how to pay yourself and how you must pay taxes on your business income.

## **What is an independent contractor?**

An independent contractor is simply someone who works for someone else, but not as an employee. For income tax purposes, you are considered a sole proprietor. The designation of "sole proprietor" is simply the default form of small business. You don't need to pay to register your business or to incorporate.

## **How does being an independent contract affect my payments?**

You still get paid for your work. But there are no deductions from your paycheck for income taxes or for social security or Medicare. Of course, you can't get out of paying taxes, and you must still pay federal and state income tax on your income from your work as an independent contractor. Taxes for social security and Medicare also must be paid; this combined tax is called self-employment tax for independent contractors.

## **How does being a sole proprietor/independent contractor work for taxes?**

When you prepare your personal income taxes, you will also prepare a form called a Schedule C, which lists your business income from all your IC work, minus any expenses.

Many IC's can file what's called a Schedule C-EZ, in which you merely list your total income and summarize your expenses. It takes only minutes to complete.

## **What expenses can I deduct as an Independent Contractor?**

You can deduct typical business expenses that you have paid. For any expenses, you must have excellent records, made at the time of the expense, to show that it was a business expense and the amount of the expense, in case of an audit.

You want to take as many legitimate deductions as you can. But you must be able to prove that the money was spent and that it was for business purposes.

### **How do I know what expenses are for business?**

The IRS says that only expenses that have a specific business purpose can be deducted. If you want to deduct expenses, these expenses must be clearly for your business, not personal. Also, the expenses must be clearly documented, with the date, amount, and business purpose.

### **Will I have to pay quarterly estimated tax?**

If your business has a profit, you might need to make estimated payments for your business taxes. But, if you have other sources of income, you may be able to increase your the withholding on income from a job to account for the additional income tax and self-employment taxes you might have to pay. Just to be clear, the estimated taxes must cover both your federal income taxes and the self-employment tax you owe for Social Security and Medicare.

First, see if you can increase the amount withheld from your pay from other income sources. If you don't have any withholding amounts to adjust, you may need help to figure out whether you will have to pay estimated taxes on your income as an independent contractor.

If you have income from the previous year, you can use that as a basis to calculate your estimated tax bill, or work with a tax advisor.

### **The tax stuff sounds complicated. Will I have to pay someone else to do my taxes?**

You may need help with (a) Schedule C or Schedule C-EZ, (b) Schedule SE to calculate the amount of self-employment taxes, and (c) the calculation of estimated taxes due. If you have a simple business tax return, with no employees or product inventory, you may be able to use one of these online business tax preparation services.

### **Will I receive a W-2 for income tax purposes?**

Instead of receive a W-2 in January of each year, you will receive a 1099-MISC form showing the total amount you earned from each client for whom you worked during that year.

If your payments from any one client are less than \$600, you won't receive a 1099-MISC form, but you still must include the amount you were paid on your business tax return.

### **How do I pay income taxes on my income as an Independent Contractor?**

First, you must determine the net income from all of your business activities. The income from your work as a sub is recorded on Schedule C. Income from your work as an IC is listed, then any deductions are taken, to get a net income number. This number is brought to Line 12 of your Form 1040. It gets added in with any other income, and then the tax is calculated on your total adjusted gross income.

## **What about state income taxes?**

Most states have income taxes, and yes, you must pay those state income taxes on your income as an independent contractor.

## **How is self-employment tax calculated and included on my tax return?**

The net income amount (the “profit”) from your Schedule C is to determine the amount of self-employment tax you owe. This calculation is done on Schedule SE. The result of this calculation is a tax amount which is added to the total income tax you must pay.

## **An example of taxes for an independent contractor:**

An independent contractor, let’s call her Carol, works for several clients in 2015 and she earns in total \$18,000 for the year, as shown on the 1099-MISC forms she received. She has no other income, but her husband Tom has a full-time job and they file a joint tax return.

She files a Schedule C-EZ for her 2015 business taxes. She can prove she drove 250 miles back and forth to work assignments, so (at the IRS mileage rate for 2015 of 57.5 cents a mile) she can deduct \$143.75. This makes her net income from her business \$18,000 less \$143.75, or \$17,856.25. This amount goes on their 1040 on Line 12: Business income (or loss).

She must also pay self-employment tax on \$17,856.25. She can use a short form Schedule SE. The result of the Schedule SE calculation show she owes \$2523.01 for self-employment tax. Carol gets credit for this amount for Social Security benefits. Half of this amount (\$1261.50) is deducted on Page 1 of her income tax return, to reduce her total adjusted gross income for the year.

To account for the additional self-employment tax, Tom could increase his withholding from his work, or Carol could begin paying estimated taxes in April 2015, taking the full amount of \$2,523.01 and dividing it by 4 and paying  $\frac{1}{4}$  each quarter (April 15, July 15, October 15, and January 15, 2016).