

YES! YOU'RE A SMALL BUSINESS

Helping Clients Understand the
Tax Liability of their Side Hustle



CASH Campaign of Maryland

Creating Assets, Savings and Hope

CASH Campaign promotes programs, products, and policies that increase the financial security of low to moderate-income individuals and families across the state.

- Free Tax Preparation and Asset Building programs
- Financial Coaching and Education
- Research and Advocacy
- Practitioner Training

Introduction

- Unemployment and technology trends have led to more people creating their own jobs
- One out of three new jobs is created by self-employed startups. Since 1980, nearly all net job creation in this country has been through businesses under five years old
- “Small Business” can range from owning a company with employees to earning income “on the side” through the “Gig” or “Sharing” economy
- Many business returns are outside the scope of VITA. BUT be aware of all business tax issues so you know when you need to refer the client elsewhere

What is the “Gig” or “Sharing” Economy” & Why do we care

- Temporary, flexible work that typically uses a website or mobile app to help match workers/service providers with customers Ex. Lyft, Uber, TaskRabbit, DogVacay etc.
- About 16% of Americans work for a temporary help agency
- Participants are treated as independent contractors or as self-employed individuals

Traditional Independent Contractor Concepts

Offers services to the public in exchange for payment

Not under the direct control of the payer

The payer only has the right to the result of the work or service provided by the independent contractor

The independent contractor directs how the work or service will be provided and what will be done

Who Is Self-Employed?

- Here are some important questions to ask:
 - *Do you create a product or provide a service for a fee that you keep for yourself?*
 - *Do you earn money on the side that you keep for yourself, even if it's only part-time or side hustle?*
 - *Do you get taxes taken out of the money you receive?*

THE CURRENT STATE OF TAXES



Income Taxes

- Taxes paid for earning or receiving income
- Not paid on every dollar earned
- Paid on the portion of income that is left over after adjustments, deductions, exemptions and tax credits

Self-Employment Tax

- An additional tax that self-employed individuals must pay to the federal government to fund Medicare and Social Security
- Due when an individual has over \$400 in self-employment income throughout the course of the year
- Because self-employed individuals work for themselves they have to contribute both the “company” and “employee” portion of the tax

Self-Employment Tax Calculation

- Calculated according to net income of the business.
- Net income = Gross business income - allowable expenses
- For 2017, the self-employment tax rate is 15.3%
- This includes both the employer and employee share of 12.4% for Social Security and 2.9% for Medicare



HOW CAN WE HELP?

**Remind them that
all income is
taxable**

- **Gross income includes all income derived from any source**
- **No matter how temporary or infrequent**
- **Even if they do not receive a tax form or a receipt**
- **Even if it's paid in cash**
- **Renting a house/room over 15 days per year triggers rental income reporting requirement**

**Tracking income
themselves
is key**

- They may not receive any tax forms

- May receive several forms that report the same income
 - *1099-MISC Miscellaneous Income*
 - *1099-K Merchant Card and Third Party Network Payments*

**Encourage the
filing of timely
and accurate
tax returns**

- There may be penalties if taxes are not filed and income isn't reported
- Provides a summary detail of income and expenses
- Can allow for certain refundable credits and possible receipt of a refund
- Payment of self-employment taxes pays into Social Security account
- Having accurate tax records can help buy a home, get a loan and sell their business

**Explain the
difference between
Income Tax and
*Self-employment Tax***

- Even if a taxpayer has an employer that is withholding payroll taxes, if there is additional business income they cannot assume these withholdings will be enough to cover self-employment taxes
- **Remember:** Self-employment tax is an *additional* tax that is added to the total tax *after* income tax liability is calculated
- It is possible to owe \$0 in income taxes but still owe self-employment tax

**Stress the
importance
and necessity
of keeping
good records**

- Required by law
- Will substantiate business deductions and lead to accurate tax preparation
- Helps to know how much business income they are making
- Lets them know how much they are paying and whether it's profitable
- Financial institutions require them for loans, etc.
- It is much harder to try recreate records later – some expenses may be missed
- Use apps to make this easier

Types of Records

- Bills
- Credit card and other receipts
- Invoices
- Mileage logs
- Canceled, imaged or substitute checks or any other proof of payment
- Account Summaries

How do you prepare a return if a taxpayer does not have records?

- This frequently happens with small business clients
- Inform the taxpayer they must keep records in the future and assist them if possible with creating a system
- Try to recreate their income
 - *Look at old credit card and bank statements*
 - *Work with the client to remember income they may have received*
- Be very conservative

**Discuss
business
deductions**

Business Deductions must be ordinary and necessary

- Ordinary → are expenses that would normally be taken by others in a similar profession
- Necessary → appropriate and essential to do the job

Car & Truck Expenses

- Standard Mileage rate (2017 at 53.5 cents)
 - Business miles ONLY
- Actual car expenses
 - Gas
 - Oil changes
 - Repairs
- Tolls
- Parking

Home office deduction

- Regular (all the time) and exclusive (only) use
- Home must be principal place of business
- Two ways to deduct:
 - Simplified method → \$5 per sq. ft. up to 300sq ft.
 - Regular method → Actual expenses based on % of home used

Other Business Expenses*

- Advertising
- Rent
- Supplies
- Cell phone bills
- Fees & commissions
- Licensing
- Cleaning/maintenance for rentals
- Repairs

***Must be ordinary and necessary**

**Encourage them to
save for possible
taxes owed at the
end of the year or to
make use of
Quarterly Estimated
Tax Payments**

- Quarterly tax payments are payments made to the IRS on income that is not subject to withholding so that no interest is due on the taxes owed throughout the year
- Due four times a year on the 15th of January, April, June and September
- Can also make these payments to state revenue agencies
- Taxes are to be paid as income is earned. Additional penalties may apply if quarterly tax payments are required but not made

Scope of VITA

- Limit your return to Schedule C-EZ (Note: *unless* up to \$25,000 in expenses are allowed.)
- Use Cash Method of Accounting
- No inventory
- Do not have net loss
- No “unallowed” passive activity loss
- No Business use of home (Home Office Deduction)
- No Employees
- Only one Business
- No Depreciation/Amortization

Resources

- CASH Campaign of Maryland Taxes and Your Business Curriculum <http://www.mdcash.academy.org> for class offerings
- Internal Revenue Service Small Business and Self-Employed Tax Center/ Sharing Economy Tax Center <https://www.irs.gov/businesses/small-businesses-self-employed>

QUESTIONS?



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