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Business Taxes for the Self-Employed: The Basics

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For anyone starting a small business, especially those who are self-employed, the Internal Revenue Service offers some basic information on filing, reporting and paying taxes.

Generally, one is self-employed if they:

- Carry on a trade or business as a sole proprietor or independent contractor, or are otherwise in business as an individual, including a part-time business
- Own an unincorporated business

Independent contractors are generally people such as doctors, daycare providers, mechanics and contractors who are in an independent trade, business or profession in which they offer their services to the public. However, whether these people are independent contractors or employees depends on the facts in each case. The general rule is that an individual is an independent contractor if the payer has the right to control or direct only the result of the work and not what will be done and how it will be done.

Reporting Number

Most businesses need to obtain an Employer Identification Number (EIN) from the IRS. A taxpayer needs to get one if they:

- Pay wages to employees
- Have a self-employed retirement plan
- Operate a business as a corporation or partnership
- Are required to file any tax returns for employment, excise, fiduciary, or alcohol, tobacco and firearms

The EIN identifies tax returns filed with the IRS. If a taxpayer does not need an EIN, they can generally use their Social Security Number (SSN) as their taxpayer identification number.

The fastest and easiest way to get an EIN is online at IRS.gov. Type "EIN" in the search box. The IRS issues the EIN immediately after validating the applicant's information.

Filing Tax Returns

As a self-employed individual, generally a taxpayer is required to file an annual federal income tax return. A return is required if their net earnings from self-employment are \$400 or more. If their net earnings are less than \$400, they still need to file an income tax return if they meet any other filing requirement listed in the [Form 1040](#) instructions.

Taxpayers need to use [Schedule C](#) or Schedule [C-EZ](#) to report income or loss from a business operated or profession practiced as a sole proprietor. Also, be sure to include any self-employment income reported on [Form 1099-MISC](#).

Taxpayers may use Schedule C-EZ instead of Schedule C only if they:

- Had business expenses of \$5,000 or less
- Use a cash method of accounting
- Did not have an inventory at any time during the year
- Did not have a net loss from the business
- Had only one business as either a sole proprietor, qualified joint venture or statutory employee

Business Expenses

Taxpayers can deduct the costs of operating their business. These costs are known as business expenses. They are costs taxpayers do not have to capitalize or include in the cost of goods sold, such as inventory for sale, but can deduct in the current year. To be deductible, a business expense must be both ordinary and necessary. An ordinary expense is one that is common and accepted in a taxpayer's field of business. A necessary expense is one that is helpful and appropriate for a business.

Business use of a Home

If a taxpayer uses part of their home for business, they may be able to deduct expenses for the business use of their home. The home office deduction is available for homeowners and renters, and applies to all types of homes.

IRS offers a [simplified](#) method for figuring this deduction. The standard method has calculation, allocation and substantiation requirements that are complex and often burdensome for small business owners. The simplified option can significantly reduce recordkeeping burden by allowing a qualified taxpayer to multiply a prescribed rate by the allowable square footage of the office instead of determining actual expenses.

Publication [587](#), Business Use of Your Home, has a full explanation of tax deductions for a home office.

Self-Employment Tax

Taxpayers must generally pay self-employment tax as well as income tax. Self-employment tax is Social Security and Medicare. It's similar to the Social Security and Medicare taxes withheld from the pay of most wage earners. Taxpayers figure self-employment tax using Form 1040, [Schedule SE](#). Taxpayers can deduct half of their self-employment tax in computing their adjusted gross income. If a taxpayer has more than one business, use one Schedule SE and combine the profits and losses from all businesses.

Estimated Tax Payments

Business taxpayers generally have to make estimated tax payments. This applies even if a taxpayer has a full-time or part-time job and their employer withholds taxes from their wages. Estimated tax is the method used to pay tax on income that is not subject to withholding. If a taxpayer doesn't make quarterly payments, they may be penalized for underpayment at the end of the tax year. Quarterly estimated tax payments are due April 15, June 15, Sept. 15 and Jan. 15. For details including a worksheet and 2015 tax rate schedules, see [Form 1040-ES](#).

Recordkeeping

Taxpayers must keep receipts, sales slips, invoices, bank deposit slips, cancelled checks and other documents. These documents, either electronic or paper files, can substantiate items of income, deductions and credits. Keeping these records will help a taxpayer pay only the tax they owe.

Unless a taxpayer has records showing the sources of receipts, they may not be able to prove that some are nonbusiness or nontaxable. Taxpayer records should show the amount of earnings reportable for self-employment tax purposes. See [Publication 583](#) for details.

Visit the IRS [video portal](#) to see a short video on recordkeeping. The portal also features a series titled, “Your Guide to an IRS Audit.” This series of videos takes the viewer through the steps of an audit from notification to closing.

Paying Taxes

IRS [Direct Pay](#) is a free, secure service that enables individual taxpayers to electronically pay a tax bill or make an estimated tax payment directly from a checking or savings account. Taxpayers receive instant confirmation that they submitted a payment. IRS systems do not retain taxpayer bank account information after payments are made.

Alternatively, individuals and businesses can pay their taxes electronically, free of charge, through the Treasury Department’s Electronic Federal Tax Payment System ([EFTPS](#)). Payments can be made via the Internet or by phone 24 hours a day, 7 days a week.

Online Learning Tools and information

- [IRS video portal](#) contains video and audio presentations on topics of interest to small businesses and individuals.
- [Small Business Taxes: The Virtual Workshop](#) contains nine interactive lessons to help new small business owners learn their tax rights and responsibilities.
- [Small Business and Self-Employed Tax Center](#)
- [Publication 334](#), Tax Guide for Small Business (For Individuals Who Use Schedule C or C-EZ)