

LB&I Concept Unit Knowledge Base – International

Library Level	Number	Title
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Book	9	Jurisdiction to Tax (Outbound)
Chapter	9.7	U.S. Possessions
Section		
Subsection		

Unit Name	U.S. Territories – Self-Employment Tax	
Primary UIL Code	9431.05	Taxation of Bona Fide Residents of U.S. Territories

Document Control Number (DCN)	JTO/C/09_07-03
Date of Last Update	08/15/17

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General Overview

U.S. Territories – Self-Employment Tax

U.S. territories have separate, autonomous income tax systems, but they do not have their own separate systems for Social Security. The Internal Revenue Service (IRS) is responsible for ensuring that self-employed individuals who live and work in U.S. territories comply with the requirements of Internal Revenue Code (IRC) Section 1401 for paying self-employment tax. This Practice Unit discusses the self-employment tax obligations of U.S. citizens and resident aliens who are self-employed in a U.S. territory and have net self-employment income of \$400 or more. U.S. territories include American Samoa, the Commonwealth of the Northern Mariana Islands (CNMI), Guam, Puerto Rico and the U.S. Virgin Islands (USVI). Bona fide residents of U.S. territories are considered U.S. residents for purposes of self-employment tax. They generally must pay self-employment tax, both social security and Medicare, to the U.S. Such individuals must report and pay self-employment tax even if their self-employment income is excludable from gross income for U.S. income tax purposes and regardless of whether a U.S. income tax return (Form 1040) is required to be filed. They report self-employment tax to the IRS on Form 1040-SS - *U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)*, or Formulario 1040-PR - *Planilla para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos para Residentes Bona Fide de Puerto Rico)*, which is the Spanish version of Form 1040-SS. Also, if their self-employment income is over the threshold amount, they must report additional Medicare tax on Form 8959.

Self-employment tax is a social security and Medicare tax primarily for individuals who work for themselves. It is similar to the social security and Medicare taxes withheld from the pay of most wage earners. An individual's payments of self-employment tax contribute to his/her coverage under the social security system. Social security coverage provides retirement benefits, disability benefits, survivors benefits and hospital insurance (Medicare) benefits. Not reporting self-employment income may result in low, or no, social security benefits upon retiring or becoming disabled.

NOTE: Nonresident aliens are not subject to self-employment tax. A nonresident alien for purposes of self-employment tax is an individual who is a nonresident alien of the United States, and is not a resident of American Samoa, Guam, Puerto Rico, CNMI or the USVI. See Treas. Reg. 1.1402(b)-1(d).



Detailed Explanation of the Concept

U.S. Territories – Self-Employment Tax


U.S. self-employment tax must be paid on net self-employment income of \$400 or more.

Analysis	Resources
<p><u>Who is self-employed?</u></p> <p>An individual is self-employed if he or she is a sole proprietor (including an independent contractor), a partner in a partnership (including a member of a multi-member limited liability company (LLC) that has elected to be treated as a partnership for federal tax purposes), or otherwise engaged in business in a capacity other than as an employee. The term sole proprietor also includes the sole member of an LLC that is disregarded for federal income tax purposes and a member of a qualified joint venture. An individual does not have to carry on regular full-time business activities to be self-employed. Individuals who have a part-time business in addition to a regular job, work on the side as an independent contractor or operate a seasonal business are also self-employed.</p> <p><u>What is net self-employment income?</u></p> <p>Self-employment income includes:</p> <ul style="list-style-type: none"> ▪ Gross income from a trade or business less the allowable deductions attributed to that trade or business. ▪ A general partner’s distributive share (whether or not distributed) of income or loss from any trade or business carried on by a partnership, excluding rental, dividends, interest and capital gain or loss. ▪ Payments received by a partner of a partnership for services rendered to the partnership (such as guaranteed payments). 	<ul style="list-style-type: none"> ▪ IRC 1402(a) ▪ Treas. Reg. 1.1401-1(a) ▪ Treas. Reg. 1.1401-1(b) ▪ Treas. Reg. 1.1402(a)-1(a)(2) ▪ Form 1040-SS Instructions ▪ Form 1040-PR Instructions ▪ Schedule SE (Form 1040) Instructions ▪ Pub. 334 - <i>Tax Guide for Small Businesses (For Individuals Who Use Schedule C or C-EZ)</i> ▪ Social Security Sec. 211 [42 U.S.C. 411]



Detailed Explanation of the Concept (cont'd)

U.S. Territories – Self-Employment Tax	
Analysis	Resources
<p><u>What is net self-employment income? (cont'd):</u> NOTE: Fees and related expenses from services performed as a public official, such as a notary public, are not included in net self-employment income.</p> <p> CAUTION: Puerto Rico is a community property jurisdiction. If an individual and his/her spouse wholly own an unincorporated business as community property and only one spouse participates in the business, all the income from that business is the self-employment income of that spouse. If both spouses participate, the income and deductions are allocated to each spouse based on their respective distributive shares.</p> <p>What does and does not constitute self-employment income is discussed in greater depth in the instructions for Forms 1040-SS and 1040-PR.</p> <p>Net self-employment income is generally computed the same way for territory income tax purposes as for U.S. self-employment tax purposes. However, some operating expenses that may be deductible on returns filed with Puerto Rico's tax agency may not be allowable in computing net income for U.S. self-employment tax purposes.</p> <p> CAUTION: The Puerto Rico return may allow the deduction of one half of self-employment tax, self-employed health insurance and contributions to qualified pension plans as business operating expenses. Although these expenses are allowed as adjustments to gross income on Form 1040, they are not deductible when computing net self-employment income on Schedule C or F of the U.S. Form 1040.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.1402(c)-2(b) ▪ Pub. 334 - <i>Tax Guide for Small Business (For Individuals Who Use Schedule C or C-EZ)</i> ▪ Schedule SE (Form 1040) Instructions ▪ IRC 1402(a)(5) ▪ Treas. Reg. 1.1402(a)-8(a) ▪ IRM 25.18.1.2 - <i>Property Rights and Federal Taxation</i> ▪ Form 1040-SS Instructions ▪ Treas. Reg. 1.1402(a)-9 ▪ IRC 162(l)(4) ▪ Social Security Sec. 211 [42 U.S.C. 411] ▪ <i>Gale v. United States</i> -768 F. Supp. 1305 (N.D.Ill.1991)

Detailed Explanation of the Concept (cont'd)

U.S. Territories – Self-Employment Tax	
Analysis	Resources
<p><u>Additional Medicare tax:</u> Self-employed individuals may be liable for additional Medicare tax for self-employment income which exceeds the threshold amount for each taxable year, as shown on Form 8959 and its instructions.</p> <p>The additional Medicare tax is reported on Form 8959, which must be attached to Form 1040, Form 1040-SS or Form 1040-PR, as applicable.</p> <p> CAUTION: The additional Medicare tax is not includible in the deduction of one-half self-employment tax.</p> <p><u>How is self-employment tax reported?</u> Individuals with net self-employment income who are subject to self-employment tax must file one of the following with the IRS:</p> <ul style="list-style-type: none"> ▪ Schedule SE. If required to file Form 1040 or Form 1040-NR with the IRS, Schedule SE is used to compute self-employment tax and is submitted with Form 1040. ▪ Form 1040-SS / Formulario 1040-PR. If not required to file Form 1040 with the IRS, Form 1040-SS is used to compute self-employment tax. Residents of Puerto Rico can file Formulario 1040-PR instead of Form 1040-SS. Formulario 1040-PR is the Spanish-language equivalent of Form 1040-SS. These forms must be filed with the Internal Revenue Service at the address shown in the instructions for Form 1040-PR and Form 1040-SS. 	<ul style="list-style-type: none"> ▪ IRC 1401(b)(2) ▪ Pub. 570 - <i>Tax Guide for Individuals with Income from U.S. Possessions.</i> ▪ Form 8959 - <i>Additional Medicare Tax</i> ▪ Form 8959 Instructions ▪ IRC 164(f)(1) ▪ Form 1040 Schedule SE - <i>Self-Employment Tax</i>

Detailed Explanation of the Concept (cont'd)

U.S. Territories – Self-Employment Tax	
Analysis	Resources
<p><u>How is self-employment tax reported? (cont'd):</u></p> <p>NOTE: These forms are due by day 15 of the fourth month after the close of the taxable year. For calendar year taxpayers, this is generally April 15. To request an automatic 6-month extension of the time to file, Form 4868 must be filed on or before this due date.</p> <p> CAUTION: Individuals who expect to owe self-employment tax of \$1,000 or more should make estimated tax payments using Form 1040-ES - <i>Estimated Tax for Individuals</i>. Failing to do so may result in an estimated tax penalty.</p> <p><u>Receiving credit for social security purposes:</u></p> <p>The Social Security Administration uses information from Form 1040-SS (or 1040-PR) to compute an individual's benefits under the social security program.</p> <p> CAUTION: Generally, the Social Security Administration will give credit only for self-employment income reported on a tax return filed within 3 years, 3 months, and 15 days after the year in which the income was earned.</p>	<ul style="list-style-type: none"> ▪ Form 1040-SS Instructions ▪ Form 1040-PR Instructions ▪ Pub. 334 - <i>Tax Guide for Small Business (For Individuals Who Use Schedule C or C-EZ)</i> ▪ <i>Social Security Handbook -1423.1</i>

Detailed Explanation of the Concept (cont'd)

U.S. Territories – Self-Employment Tax	
Analysis	Resources
<p><u>Applicable penalties:</u></p> <p>Individuals who do not properly and timely report and pay self-employment tax may be subject to the following:</p> <ul style="list-style-type: none"> ▪ Estimated Tax Penalty ▪ Failure to File Penalty ▪ Failure to Pay Penalty ▪ Accuracy-Related Penalty ▪ Civil Fraud Penalty ▪ Fraudulent Failure to File Penalty 	<ul style="list-style-type: none"> ▪ IRM 4.19.17.8 - <i>Puerto Rican Non-Filed Self-Employment Returns 1040PR/SS</i> ▪ IRC 6654(a) ▪ IRC 6651(a)(1) ▪ IRM 20.1.2.2.7 - <i>Failure to File a Tax Return—IRC 6651(a)(1)</i> ▪ IRC 6651(a)(2) ▪ IRC 6662(a) ▪ IRC 6663(a) ▪ IRM 25.1.6.1 - <i>Overview</i> ▪ IRM 4.10.6.2.2 - <i>Fraud</i> ▪ IRC 6651(f) ▪ IRM 20.1.2.2.7.5 - <i>Fraudulent Failure to File—IRC 6651(f)</i>

Index of Referenced Resources

U.S. Territories – Self-Employment Tax

IRC 162(l)(4)

IRC 164(f)(1)

IRC 1401

IRC 1402

IRC 6651

IRC 6654(a)

IRC 6662(a)

IRC 6663(a)

Treas. Reg. 1.1401-1

Treas. Reg. 1.1402

IRM 4.10.6.2.2 - *Fraud*

IRM 4.19.17.8 - *Puerto Rican Non-Filed Self-Employment Returns 1040PR/SS*

IRM 20.1.2.2.7 - *Failure to File a Tax Return—IRC 6651(a)(1)*

IRM 20.1.2.2.7.5 - *Fraudulent Failure to File—IRC 6651(f)*

IRM 25.1.6.1 - *Overview*

IRM 25.18.1.2 - *Property Rights and Federal Taxation*

Index of Referenced Resources (cont'd)

U.S. Territories – Self-Employment Tax

Form 1040 Schedule SE - *Self-Employment Tax*

Schedule SE (Form 1040) Instructions

Form 1040-PR - *Formulario 1040-PR - Planilla para la Declaración de la Contribución Federal sobre el Trabajo por Cuenta Propia (Incluyendo el Crédito Tributario Adicional por Hijos para Residentes Bona Fide de Puerto Rico)*

Form 1040-PR Instructions

Form 1040-SS - *U.S. Self-Employment Tax Return (Including the Additional Child Tax Credit for Bona Fide Residents of Puerto Rico)*

Form 1040-SS Instructions

Form 8959 - *Additional Medicare Tax*

Form 8959 Instructions

Pub. 334 - *Tax Guide for Small Business (For Individuals Who Use Schedule C or C-EZ)*

Pub. 570 - *Tax Guide for Individuals with Income from U.S. Possessions*

Social Security Sec. 211 [42 U.S.C. 411]

Social Security Handbook -1423.1

Gale v. United States -768 F. Supp. 1305 (N.D.Ill.1991)

Training and Additional Resources

U.S. Territories – Self-Employment Tax	
Type of Resource	Description
Databases / Research Tools	▪ <i>BNA Tax Management U.S. Income Portfolio 392-6th – Sec. II</i>

Glossary of Terms and Acronyms

Term/Acronym	Definition
CNMI	Commonwealth of the Northern Mariana Islands
DCN	Document Control Number
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
LLC	Limited Liability Company
USVI	United States Virgin Islands

Index of Related Practice Units

Associated UIL	Related Practice Unit	DCN
9431.07	U.S. Territories – Determining Bona Fide Residency Status	JTO/P/09_07-01 (formerly JTO/PUO/P_9.7_07(2015))