2006 Instructions for Schedule SE (Form 1040)

Self-Employment Tax

Section references are to the Internal Revenue Code unless otherwise noted.

What's New

• For 2006, the maximum amount of self-employment income subject to social security tax is $94,200.
• If you are a debtor in a chapter 11 bankruptcy case, you must pay self-employment tax on your net earnings from self-employment, even though the bankruptcy estate pays the income tax on your net profit. See Chapter 11 Bankruptcy Cases on page SE-2.

General Instructions

Who Must File Schedule SE
You must file Schedule SE if:
• Your net earnings from self-employment (see page SE-2) from other than church employee income were $400 or more, or
• You had church employee income of $108.28 or more—see Employees of Churches and Church Organizations below.

Who Must Pay Self-Employment (SE) Tax?
Self-Employed Persons
You must pay SE tax if you had net earnings of $400 or more as a self-employed person. If you are in business for yourself or you are a farmer, you are self-employed.

You must also pay SE tax on your share of certain partnership income and your guaranteed payments. See Partnership Income or Loss on page SE-2.

Employees of Churches and Church Organizations
If you had church employee income of $108.28 or more, you must pay SE tax. Church employee income is wages you received as an employee (other than as a minister or member of a religious order) of a church or qualified church-controlled organization that has a certificate in effect electing an exemption from employer social security and Medicare taxes.

Ministers and Members of Religious Orders
In most cases, you must pay SE tax on salaries and other income for services you performed as a minister, a member of a religious order who has not taken a vow of poverty, or a Christian Science practitioner. But if you filed Form 4361 and received IRS approval, you will be exempt from paying SE tax on those net earnings. If you had no other income subject to SE tax, enter “Exempt—Form 4361” on Form 1040, line 58. However, if you had other earnings of $400 or more subject to SE tax, see line A at the top of Long Schedule SE.

Additional Information. See Pub. 225 or Pub. 334.

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You must pay SE tax if you had net earnings of $400 or more as a self-employed person. If you are in business for yourself or you are a farmer, you are self-employed.

Use Schedule SE (Form 1040) to figure the tax due on net earnings from self-employment. The Social Security Administration uses the information from Schedule SE to figure your benefits under the social security program. This tax applies no matter how old you are and even if you are already getting social security or Medicare benefits.

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Additional Information. See Pub. 225 or Pub. 334.
Medicare taxes to only the country you live in.

The United States now has social security agreements with the following countries: Austria, Australia, Belgium, Canada, Chile, Finland, France, Germany, Greece, Ireland, Italy, Japan, Luxembourg, the Netherlands, Norway, Portugal, South Korea, Spain, Switzerland, and the United Kingdom. Additional agreements are expected in the future. If you have questions about international social security agreements, you can:
1. Visit the Social Security Administration (SSA) website at www.socialsecurity.gov/international
2. Call the SSA’s Office of International Programs at:
   a. (410) 965-0144 for questions on benefits under agreements, or
   b. (410) 965-3549 for questions on the coverage rules of the agreements, or
3. Write to Social Security Administration, Office of International Programs, P.O. Box 17741, Baltimore, MD 21235-7741.

If your self-employment income is exempt from SE tax, you should get a statement from the appropriate agency of the foreign country verifying that your self-employment income is subject to social security coverage in that country. If the foreign country will not issue the statement, contact the SSA at the address shown above. Do not complete Schedule SE. Instead, attach a copy of the statement to Form 1040 and enter “Exempt, see attached statement” on Form 1040, line 58.

Chapter 11 Bankruptcy Cases
While you are a debtor in a chapter 11 bankruptcy case, your net profit or loss from self-employment (for example, from Schedule C or Schedule F) will not be included in your Form 1040 income. Instead, it will be included on the income tax return (Form 1041) of the bankruptcy estate. However, you—not the bankruptcy estate—are responsible for paying self-employment tax on your net earnings from self-employment.

Enter on the dotted line to the left of Schedule SE, line 3, “Chap. 11 bankruptcy income” and the amount of your net profit or (loss). Combine that amount with the total of lines 1 and 2 (if any) and enter the result on line 3.

For other reporting requirements, see page 22 in the instructions for Form 1040.

More Than One Business
If you had two or more businesses, your net earnings from self-employment are the combined net earnings from all of your businesses. If you had a loss in one business, it reduces the income from another. Figure the combined SE tax on one Schedule SE.

Joint Returns
Show the name of the spouse with SE income on Schedule SE. If both spouses have SE income, each must file a separate Schedule SE. However, if one spouse qualifies to use Short Schedule SE (front of form) and the other must use Long Schedule SE (back of form), both can use the same earnings base. One spouse should complete the front and the other the back.

Include the total profits or losses from all businesses on Form 1040, as appropriate. Enter the combined SE tax on Form 1040, line 58.

Community Income
In most cases, if any of the income from a business (including farming) is community income, all of the income from that business is the SE earnings of the spouse who carried on the business. The facts in each case will determine which spouse carried on the business. If you and your spouse are partners in a partnership, see the Partnership Income or Loss on this page.

If you and your spouse had community income and file separate returns, attach Schedule SE to the return of the spouse with the SE income. Also, attach Schedule(s) C, C-EZ, or F to the return of each spouse.

If you are the spouse who carried on the business, you must include on Schedule SE, line 3, the net profit or (loss) reported on the other spouse’s Schedule C, C-EZ, or F (except income not included in net earnings from self-employment as explained on page SE-1). Enter on the dotted line to the left of Schedule SE, line 3, “Community Income Taxed to Spouse” and the amount of any net profit or (loss) allocated to your spouse as community income. Combine that amount with the total of lines 1 and 2 and enter the result on line 3.

Fiscal Year Filers
If your tax year is a fiscal year, use the tax rate and earnings base that apply at the time the fiscal year begins. Do not prorate the tax or earnings base for a fiscal year that overlaps the date of a rate earnings base change.

Net Earnings From Self-Employment
What Is Included in Net Earnings From Self-Employment?
In most cases, net earnings include your net profit from a farm or nonfarm business. If you were a partner in a partnership, see the following instructions.

Partnership Income or Loss
If you had two or more businesses, your net earnings from self-employment are the spouse, even in community property states.

Fiscal Year Filers
If your tax year is a fiscal year, use the tax rate and earnings base that apply at the time the fiscal year begins. Do not prorate the tax or earnings base for a fiscal year that overlaps the date of a rate earnings base change.

Specific Instructions
Read the chart on page 1 of Schedule SE to see if you can use Section A, Short Schedule SE, or if you must use Section B, Long Schedule SE. For either section, you need to know what to include as net earnings from self-employment. Read the following instructions to see what to include as net earnings and how to fill in either Short or Long Schedule SE, lines 1 and 2. Enter all negative amounts in parentheses.
else’s land for a share of the crops or live-
stock produced (or a share of the proceeds
from the sale of them). This applies even if
you paid another person (an agent) to do the
actual work or management for you. Report
your net earnings for income tax purposes
on Schedule F (Form 1040) and for SE tax
purposes on Schedule SE. See Pub. 225 for
details.

Other Income and Losses
Included in Net Earnings
From Self-Employment

1. Rental income from a farm if, as land-
lord, you materially participated in the pro-
duction or management of the production
of farm products on this land. This income
is farm earnings. To determine whether you
materially participated in farm manage-
ment or production, do not consider the ac-
tivities of any agent who acted for you. The
material participation tests are explained in
Pub. 225.

2. Cash or a payment-in-kind from the
Department of Agriculture for participating
in a land diversion program.

3. Payments for the use of rooms or
other space when you also provided sub-
stantial services. Examples are hotel rooms,
boarding houses, tour groups or homes,
parking lots, warehouses, and stor-
age garages.

4. Income from the retail sale of newspa-
per and magazines if you were age 18 or
older and kept the profits.

5. Amounts received by current or for-
mer self-employed insurance agents and
salespersons that are:
   a. Paid after retirement but figured as a
      percentage of commissions received from
      the paying company before retirement,
   b. Renewal commissions, or
   c. Deferred commissions paid after re-
      tirement for sales made before retirement.

   However, certain termination payments re-
ceived by former insurance salespersons are
not included in net earnings from self-employment (as explained in item 9
Under Income and Losses Not Included in Net Earnings From Self-Employment on this page).

6. Income of certain crew members of
fishing vessels with crews of normally
fewer than 10 people. See Pub. 334 for de-
tails.

7. Fees as a state or local government
employee if you were paid only on a fee
basis and the job was not covered under a
federal-state social security coverage
agreement.

8. Interest received in the course of any
trade or business, such as interest on notes
or accounts receivable.

9. Fees and other payments received by
you for services as a director of a corpora-
tion.

10. Recapture amounts under sections
179 and 280F that you included in gross
income because the business use of the
property dropped to 50% or less. Do not in-
clude amounts you recaptured on the dis-
position of property. See Form 4797.

11. Fees you received as a professional
fiduciary. This may also apply to you as a
nonprofessional fiduciary if the fees relate to active participation in the op-
eration of the estate’s business, or the man-
agement of an estate that required extensive
management activities over a long period of
time.

12. Gain or loss from section 1256 con-
tracts or related property by an employee
or commodities dealer in the normal course of
dealing in or trading section 1256 con-
tracts.

Income and Losses Not
Included in Net Earnings
From Self-Employment

1. Salaries, fees, etc., subject to social
security or Medicare tax that you received
for performing services as an employee, in-
cluding service performed as a public offi-
cial (except as a fee basis government employee as explained in item 7 under
Other Income and Losses Included in Net
Earnings From Self-Employment) or as an
employee or employee representative
under the railroad retirement system.

2. Fees received for services performed
as a notary public. If you had no other in-
come subject to SE tax, enter “Exempt—
Notary” on Form 1040, line 58; do not file
Schedule SE. However, if you had other
earnings of $400 or more subject to SE tax,
enter “Exempt—Notary” and the amount of
your net profit as a notary public from
Schedule C or Schedule C-EZ on the dotted
line to the left of Schedule SE, line 3. Sub-
tract that amount from the total of lines 1
and 2 and enter the result on line 3.

3. Income you received as a retired part-
er in a partnership, or a fee basis partner
in a limited partnership that provides for
lifelong periodic retirement payments if you had no other interest in the
partnership and did not perform services for the company for the year.

4. Income from real estate rentals if you
did not receive the income in the course of
a trade or business as a real estate dealer.

Report this income on Schedule E.

5. Income from farm rentals (including
rentals paid in crop shares) if, as landlord,
you did not materially participate in the
production or management of the produc-
tion of farm products on the land. See Pub.
225 for details.

6. Dividends on shares of stock and in-
terest on bonds, notes, etc., if you did not
receive the income in the course of your
trade or business as a dealer in stocks or
securities.

7. Gain or loss from:
   a. The sale or exchange of a capital as-
set;
   b. The sale, exchange, involuntary con-
version, or other disposition of property un-
less the property is stock in trade or other
property that would be includible in inven-
tory, or held primarily for sale to customers
in the ordinary course of the business;
or
   c. Certain transactions in timber, coal,
or domestic iron ore.

8. Net operating losses from other years.

9. Termination payments you received
as a former insurance salesperson if all of
the following conditions are met.
   a. The payment was received from an
insurance company because of services you
performed as an insurance salesperson for
the company.
   b. The payment was received after ter-
mination of your agreement to perform
services for the company.
   c. You did not perform any services for
the company after termination and before
the end of the year in which you received
the payment.
   d. You entered into a covenant not to
compete against the company for at least a
1-year period beginning on the date of ter-
mination.
   e. The amount of the payment depended
primarily on policies sold by or credited
to your account during the last year of
the agreement, or the extent to which those pol-
icy’s remained in force for some period after
termination, or both.
   f. The amount of the payment did not
depend on any extent of service or
overall earnings from services performed
for the company (regardless of whether eli-
sibility for the payment depended on length
of service).

Statutory Employee Income

If you were required to check the box on
Schedule C or C-EZ, line 1, because you
were a statutory employee, do not include
the net profit (or loss) from that Schedule
C or C-EZ, line 31 (or the net profit from
Schedule C-EZ, line 3), or on Long Schedule
SE, line 2. But if you file Long Schedule
SE, be sure to include statutory employee
social security wages and tips from Form
W-2 on line 8a.

Optional Methods

How Can the Optional Methods
Help You?

Social security coverage. The optional
methods may give you credit toward your
social security coverage even though you
have a loss or a small amount of income
from self-employment.

Earned income credit (EIC). Using the op-
tional methods may qualify you to claim
the EIC or give you a larger credit if your
net earnings from self-employment (deter-
mined without using the optional methods)

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are less than $1,600. Figure the EIC with and without using the optional methods to see if the optional methods will benefit you.

**Additional child tax credit.** Using the optional methods may qualify you to claim the additional child tax credit or give you a larger credit if your net earnings from self-employment (determined without using the optional methods) are less than $1,600. Figure the additional child tax credit with and without using the optional methods to see if the optional methods will benefit you.

**Child and dependent care credit.** The optional methods may help you qualify for this credit or give you a larger credit if your net earnings from self-employment (determined without using the optional methods) are less than $1,600. Figure this credit with and without using the optional methods to see if the optional methods will benefit you.

**Self-employed health insurance deduction.** The optional methods of computing net earnings from self-employment may be used to figure your self-employed health insurance deduction.

**Using the optional methods may give you the benefits described above, but they may also increase your SE tax.**

**Farm Optional Method**

You may use this method to figure your net earnings from farm self-employment if your gross farm income was $2,400 or less or your net farm profits were less than $1,733. Net farm profits are the total of the amounts from:
- Schedule F (Form 1040), line 36, and
- Schedule K-1 (Form 1065), box 14, code A (from farm partnerships).

There is no limit on how many years you can use this method.

Under this method, you report on Part II, line 15, two-thirds of your gross farm income, up to $1,600, as your net earnings. This method can increase or decrease your net earnings from farm self-employment even if the farming business had a loss. You can change the method after you file your return. That is, you can change from the regular to the optional method or from the optional to the regular method. To do this, file Form 1040X.

For a farm partnership, figure your share of gross income based on the partnership agreement. With guaranteed payments, your share of the partnership’s gross income is your guaranteed payments plus your share of the gross income after it is reduced by all guaranteed payments made by the partnership. If you were a limited partner, include only guaranteed payments for services you actually rendered to or on behalf of the partnership.

**Nonfarm Optional Method**

You may be able to use this method to figure your net earnings from nonfarm self-employment if your net nonfarm profits were less than $1,733 and also less than 72.189% of your gross nonfarm income. Net nonfarm profits are the total of the amounts from:
- Schedule C (Form 1040), line 31,
- Schedule C-EZ (Form 1040), line 3,
- Schedule K-1 (Form 1065), box 14, code A (from other than farm partnerships), and
- Schedule K-1 (Form 1065-B), box 9, code J1.

To use this method, you also must be regularly self-employed. You meet this requirement if your actual net earnings from self-employment were $400 or more in 2 of the 3 years preceding the year you use the nonfarm optional method. The net earnings of $400 or more could be from either farm or nonfarm earnings or both. The net earnings include your distributive share of partnership income or loss subject to SE tax. Use of the nonfarm optional method from nonfarm self-employment is limited to 5 years. The 5 years do not have to be consecutive.

Under this method, you report on Part II, line 17, two-thirds of your gross nonfarm income, up to $1,600, as your net earnings. But you cannot report less than your actual net earnings from nonfarm self-employment. You can change the method after you file your return. That is, you can change from the regular to the optional method or from the optional to the regular method. To do so, file Form 1040X.

Figure your share of gross income from a nonfarm partnership in the same manner as a farm partnership. See Farm Optional Method on this page for details.

**Using Both Optional Methods**

If you can use both methods, you can report less than your total actual net earnings from farm and nonfarm self-employment, but you cannot report less than your actual net earnings from nonfarm self-employment alone.

If you use both methods to figure net earnings, you cannot report more than $1,600 of net earnings from self-employment.