

Tax Alert

What the Self-Employed Need to Know About Employment Taxes

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In addition to income tax, you must pay Social Security and Medicare taxes on earned income, such as salary and self-employment income. The 12.4% Social Security tax applies only up to the Social Security wage base of \$118,500 for 2016. **All** earned income is subject to the 2.9% Medicare tax.

The taxes are split equally between the employee and the employer. But if you're self-employed, you pay both the employee and employer portions of these taxes on your self-employment income.

Additional 0.9% Medicare Tax

Another employment tax that higher-income taxpayers must be aware of is the additional 0.9% Medicare tax. It applies to FICA wages and net self-employment income exceeding \$200,000 per year (\$250,000 for married filing jointly and \$125,000 for married filing separately).

If your wages or self-employment income varies significantly from year to year or you're close to the threshold for triggering the additional Medicare tax, income timing strategies may help you avoid or minimize it. For example, as a self-employed taxpayer, you may have flexibility on when you purchase new equipment or invoice customers. If your self-employment income is from a part-time activity and you're also an employee elsewhere, perhaps you can time with your employer when you receive a bonus.

Something else to consider in this situation is the withholding rules. Employers must withhold the additional Medicare tax beginning in the pay period when wages exceed \$200,000 for the calendar year — without regard to an employee's filing status or income from other sources. So your employer might **not** withhold the tax even though you **are** liable for it due to your self-employment income.

If you *do* owe the tax but your employer isn't withholding it, consider filing a W-4 form to request additional **income** tax withholding, which can be used to cover the shortfall and avoid interest and penalties. Or you can make estimated tax payments.

Deductions for the Self-Employed

For the self-employed, the employer portion of employment taxes (6.2% for Social Security tax and 1.45% for Medicare tax) is deductible above the line. (No portion of the additional Medicare tax is deductible, because there's no employer portion of that tax.)

As a self-employed taxpayer, you may benefit from other above-the-line deductions as well. You can deduct 100% of health insurance costs for yourself, your spouse, and your dependents, up to your net self-employment income. You also can deduct contributions to a retirement plan and, if you're eligible, an HSA for yourself. Above-the-line deductions are particularly valuable because they reduce your adjusted gross income (AGI) and modified AGI (MAGI), which are the triggers for certain additional taxes and the phase outs of many tax breaks. Contact us for more information.