



Self-Employment Tax

2016



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Self-Employment Tax

Who Pays Self-Employment Tax

Taxpayers pay self-employment (SE) tax when net earnings from self-employment are \$400 or more. A taxpayer is self-employed if he or she carries on a trade or business as a sole proprietor (including farmers) or as a general partner in a partnership. A trade or business generally is an activity carried on for a livelihood or in good faith to make a profit. Facts and circumstances determine whether or not an activity is a trade or business.

Self-Employment Tax

Self-employment tax consists of the taxes paid for Social Security and Medicare. As an employee, the employer pays half of the tax and the other half is deducted from the employee's pay. By contrast, a self-employed taxpayer must pay both halves of these taxes. If Additional Medicare Tax is due, it is paid by the taxpayer and not the employer. See *Additional Medicare Tax*, below.

Social Security portion. For 2015, the Social Security portion of self-employment tax is 12.4%.

Maximum income subject to Social Security tax. The maximum amount of self-employment income subject to Social Security tax for 2015 is \$118,500.

Medicare portion. The Medicare portion of self-employment tax is 2.9%.

Maximum income subject to Medicare tax. Unlike the income limit subject to Social Security tax, there is no income limit for Medicare taxes.

Additional Medicare Tax. A 0.9% additional Medicare tax applies to self-employment income over \$200,000 (\$250,000 MFJ or \$125,000 MFS). The Additional Medicare Tax is reported on Form 8959, *Additional Medicare Tax*.

Deduction for self-employment tax. For 2015, the deduction allowed for self-employment tax is one-half of the self-employment tax figured on Schedule SE (Form 1040).

Percentage of income subject to self-employment tax. Because of the deduction, the percentage of net self-employment income subject to self-employment tax is 92.35%.

Schedule SE (Form 1040), Self-Employment Tax. Self-employment tax is computed on Schedule SE. The deduction for one-half of self-employment tax on Form 1040 is also computed using Schedule SE and then reported as an adjustment to income on Form 1040.

Claim all deductions. The Self-Employment Contributions Act of 1954 requires every taxpayer to claim all allowable business deductions, including depreciation, in computing net earnings from self-employment for SE tax purposes. Penalties apply for making a false statement or representation in connection with any matter arising under the act.

Example: Donna is self-employed. After deducting business expenses, her net self-employment income is \$100,000. Her SE tax and deduction for one-half of SE tax are computed as follows.

- | | |
|---|-----------|
| 1) Self-employment income..... | \$100,000 |
| 2) Multiply line 1 by 92.35 % | \$92,350 |
| 3) SE tax. Multiply line 2 by 15.3% | \$14,130 |
| 4) Deduction for one-half of SE tax. | |
| Multiply line 3 by 50% | \$7,065 |

In computing her federal income tax, Donna can deduct \$7,065 as one-half of her self-employment tax. In addition to federal income tax, Donna must pay SE tax of \$14,130.



Self-Employment Tax

Self-Employment Tax Optional Methods

By paying SE tax, taxpayers earn Social Security credits (up to four credits per year). For 2015, one credit is earned for each quarter of the year in which the taxpayer has self-employment earnings of \$1,220.

Optional method. Taxpayers with net annual business or farm income that is too low to qualify for Social Security credits may use an optional method to calculate self-employment tax.

- Farmers may use this method as often as desired. All others may use it a maximum of five times. The five years need not be consecutive.
- More SE tax is paid in the year the method is used, but the taxpayer may qualify for higher Social Security benefits in the future.
- The optional method is an election the taxpayer makes on Part II, Schedule SE.
- Gross income and net profit limits apply.

Self-employment tax optional method limits:

Optional method	2015
Farm gross income limit	\$7,320
Farm net profits limit.....	\$5,284
Nonfarm net profits limit	\$5,284

Example: John is a farmer. Due to unusually high expenses in 2015, his net profit for the year is \$3,250. In order to earn four Social Security credits for the year, John elects to use the optional method for computing SE tax.

Other Common Self-Employment Tax Situations

Hobby income. Activities not conducted on a for-profit basis are not subject to SE tax.

Partnership income. Guaranteed payments and a general partner's distributive share of income are subject to SE tax.

Department of Agriculture payments. Payments for participating in land diversion programs are subject to SE tax. **Exception:** CRP payments to a nonfarmer are considered rental income and not subject to SE tax.

This brochure contains general information for taxpayers and should not be relied upon as the only source of authority. Taxpayers should seek professional tax advice for more information.

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Community property states. State laws that say income is earned one-half by each spouse do not apply to SE tax. The spouse who actually earns the self-employment income is subject to SE tax.

Rental real estate. Not subject to SE tax unless substantial services are provided, such as a hotel or tourist camp.

Notary public. Income from services as a notary public is exempt from SE tax.

Corporate director fees. These fees are subject to SE tax.

Church employee. SE tax is due on wages exceeding \$108.28 (unless the taxpayer is a minister or member of a religious order) if the employer has a certificate in effect electing an exemption from employee Social Security and Medicare taxes.

Ministers and members of a religious order. SE tax is due on salaries and other income for religious services. Housing allowance income may be subject to SE tax. A member from a recognized religious group can apply for an exemption from SE tax. Members of a religious order who have taken a vow of poverty are exempt from SE tax.

Kids in business. A child under 18 delivering newspapers to customers is exempt from SE tax. A child under age 21 who is performing domestic services for his or her parent is exempt from SE tax. A child under age 18 who is performing domestic services in a private home of the employer is exempt from SE tax if the services are not the principal occupation of the child.

Contact Us

There are many events that occur during the year that can affect your tax situation. Preparation of your tax return involves summarizing transactions and events that occurred during the prior year. In most situations, treatment is firmly established at the time the transaction occurs. However, negative tax effects can be avoided by proper planning. Please contact us in advance if you have questions about the tax effects of a transaction or event, including the following:

- Pension or IRA distributions.
- Significant change in income or deductions.
- Job change.
- Marriage.
- Attainment of age 59½ or 70½.
- Sale or purchase of a business.
- Sale or purchase of a residence or other real estate.
- Retirement.
- Notice from IRS or other revenue department.
- Divorce or separation.
- Self-employment.
- Charitable contributions of property in excess of \$5,000.