Income Taxes

Federal Taxes for Self-Employed

Generally, you are self-employed if you carry on a trade or business as a sole proprietor, an independent contractor, or a member of a partnership. The business itself will not pay income tax. Instead, these business structures are subject to "pass-through taxation," meaning that you, personally are responsible for paying tax on income from the business as part of your personal state tax return.

Self-Employment Tax

Self-employment tax is similar to the Social Security and Medicare taxes that are withheld from the paycheck of an employee of a company. It is required if net earnings from self-employment are $400 or more. The rate for self-employment tax is 15.3%, 12.4% for Social Security and 2.9% for Medicare, and is applied to net earnings. More information on self-employment taxes can be found here.

Income Tax

Self-employed individuals must pay federal income tax on the net earnings receive during the year (this tax is separate from self-employment tax). An employee usually has federal income tax withheld from his or her pay, but self-employed individuals will need to pay estimated income taxes during the year.

Quarterly Estimated Tax Payments

Self-employed individuals are expected to submit quarterly estimated tax payments for both self-employment tax and federal income tax. Form 1040-ES, Estimated Tax for Individuals, contains a worksheet that can be used to help determine if you are required to pay quarterly estimated tax payments. Form 1040-ES also contains blank vouchers you can use when you mail your estimated tax payments. You can also use the Electronic Federal Tax Payment System (EFTPS) for submitting these payments. See the Estimated Taxes page for more information.

Annual Tax Return

All self-employed individuals must include the income from their business in their personal income tax return. The form you use depends on how your business is organized.

- Sole Proprietorship/Independent Contractor file Schedule C as part of their personal tax return (ex. Form 1040) to report the net earnings from the business. You will also need to complete Schedule SE to determine your self-employment tax and will need to use the net earnings from Schedule C to calculate the amount of self-employment tax for the year.

- Partnerships file an information return (Form 1065) to report their income, gains, losses, deductions, credits, etc. The Form 1065 will be filed with the IRS and each partner will be provided with a Schedule K-1 to incorporate the information into their personal income tax return.

Federal Taxes for Corporations

If you choose to structure your business entity as a corporation, you'll need to decide whether to set up the corporation as an S-corporation or a C-corporation. The primary differences between S-corp and a C-corp are how they're taxed and their ownership restrictions. A C-corp is the default type of corporation, and the net earnings from the business are subject to the corporate tax rate. C-corps do not have any restrictions on the number of owners (i.e. shareholders). An S-corp is a "pass-through taxation" entity. The net earnings from an S-corp are not subject to corporate tax rates, but instead are passed through to the shareholders and reported on the shareholder's personal income tax return. Ownership of a S-corp is limited to 100 shareholders. If you decide to set up as an S-corp, you must apply to the IRS using Form 2553.

State Income Taxes

Generally, state income tax for businesses is similar to federal income tax (note: there is no state self-employment tax). Businesses operating as a sole proprietorship, partnership, or S-corp are considered pass-through taxation entities for the purpose of filing and paying state income taxes. These types of business will likely need to file quarterly estimated tax payments to the state and file annual tax returns to the state (similar to annual federal tax returns).