

# The pitfalls of self-employed individuals.

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Presented by

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# Tax Obligations

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- Self-employed individuals are subject to a variety of different taxes.
  - Federal Income Tax
  - Social Security and Medicare tax
    - 12.4% and 1.45
  - State Income Tax (if applicable)
  - Additional Medicare Tax
    - .9% on earned income over 200,000



# Tax Reporting

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- Year Tax Filing
  - Sch C
  - 1120-S
  - 1065
- Quarterly Estimated Taxes
  - 4/15
  - 6/15
  - 9/15
  - 12/15 or 1/15





# Legal Structure

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- The choice of legal structure, such as operating as a sole proprietor or forming a limited liability company (LLC), has significant implications for liability, tax obligations, and the ability to make specific business elections.
  - For example, a single-member LLC is disregarded as an entity separate from its owner for income tax purposes unless an election is made to treat the LLC as a C or S Corporation.
  - This decision impacts how income and deductions are reported and can affect the owner's liability.



# Estimated Tax Payments

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- Estimated tax payments are crucial for individuals and entities that do not have taxes withheld from their income.
- The IRS mandates that taxes be paid as income is earned or received throughout the year. Failure to make estimated tax payments can result in penalties, even if a refund is due when filing the tax return.
- It is advised to use Form 1040-ES, "Estimated Tax for Individuals," to estimate and pay quarterly taxes. This process helps manage cash flow and avoids accumulating a significant tax liability at the end of the year.
- There is a 90% and 110% Rule for estimated tax payments, explained next.



# 90% Rule

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- The 90% rule generally applies to taxpayers whose adjusted gross income (AGI) for the preceding tax year was \$150,000 or less (\$75,000 or less if married filing separately). Under this rule, the required annual payment is the lesser of:
  - 90% of the tax shown on the return for the current taxable year, or
  - 100% of the tax shown on the return for the preceding taxable year, provided the preceding year was a full 12-month year and a return was filed.



# 110% Rule

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- The 110% rule applies to taxpayers whose AGI for the preceding tax year was more than \$150,000 (\$75,000 if married filing separately). For these taxpayers, the required annual payment is the lesser of:
  - 90% of the tax shown on the return for the current taxable year, or
  - 110% of the tax shown on the return for the preceding taxable year, provided the preceding year was a full 12-month year and a return was filed.



# Deductions

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- Self-employed individuals can deduct business expenses, but these must be ordinary and necessary.
- The complexity of what constitutes a deductible expense requires a deep understanding of tax regulations to maximize deductions legally and effectively.
- Misinterpretation or misapplication of these rules can lead to missed opportunities for deductions or, conversely, penalties for incorrect deductions.

Questions?

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# IRS Reference Materials

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- Publication 334: Tax Guide for Small Business (For Individuals Who Use Schedule C) (2023)
  - <https://www.irs.gov/forms-pubs/about-publication-334>
- Schedule C (Form 1040), Profit or Loss from Business (Sole Proprietorship)
  - <https://www.irs.gov/forms-pubs/about-schedule-c-form-1040>
- Publication 505 (2024), Tax Withholding and Estimated Tax
  - <https://www.irs.gov/publications/p505>

# Contact Information

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