



Do you want to go into business for yourself?

Many people who launch small businesses start out as sole proprietors. Here are nine tax rules and considerations involved in operating as that entity.

1. You may qualify for the pass-through deduction. To the extent your business generates qualified business income, you are eligible to claim the 20% pass-through deduction, subject to limitations. The deduction is taken “below the line,” meaning it reduces taxable income, rather than being taken “above the line” against your gross income. However, you can take the deduction even if you don’t itemize deductions and instead claim the standard deduction.

2. Report income and expenses on Schedule C of Form 1040. The net income will be taxable to you regardless of whether you withdraw cash from the business. Your business expenses are deductible against gross income and not as itemized deductions. If you have losses, they will generally be deductible against your other income, subject to special rules related to hobby losses, passive activity losses and losses in activities in which you weren’t “at risk.”

3. Pay self-employment taxes. For 2020, you pay self-employment tax (Social Security and Medicare) at a 15.3% rate on your net earnings from self-employment of up to \$137,700, and Medicare tax only at a 2.9% rate on the excess. An additional 0.9% Medicare tax (for a total of 3.8%) is imposed on self-employment income in excess of \$250,000 for joint returns; \$125,000 for married taxpayers filing separate returns; and \$200,000 in all other cases. Self-employment tax is imposed in addition to income tax, but you can deduct half of your self-employment tax as an adjustment to income.

4. Make quarterly estimated tax payments. For 2019, these are due April 15, June 15, September 15 and January 15, 2021.

5. You may be able to deduct home office expenses. If you work from a home office, perform management or administrative tasks there, or store product samples or inventory at home, you may be entitled to deduct an allocable portion of some costs of maintaining your home. And if you have a home office, you may be able to deduct expenses of traveling from there to another work location.

6. You can deduct 100% of your health insurance costs as a business expense. This means your deduction for medical care insurance won't be subject to the rule that limits medical expense deductions.

7. Keep complete records of your income and expenses. Specifically, you should carefully record your expenses in order to claim all the tax breaks to which you're entitled. Certain expenses, such as automobile, travel, meals, and office-at-home expenses, require special attention because they're subject to special recordkeeping rules or deductibility limits.

8. If you hire employees, you need to get a taxpayer identification number and withhold and pay employment taxes.

9. Consider establishing a qualified retirement plan. The advantage is that amounts contributed to the plan are deductible at the time of the contribution and aren't taken into income until they're withdrawn. Because many qualified plans can be complex, you might consider a SEP plan, which requires less paperwork. A SIMPLE plan is also available to sole proprietors that offers tax advantages with fewer restrictions and administrative requirements. If you don't establish a retirement plan, you may still be able to contribute to an IRA.

Seek assistance

If you want additional information regarding the tax aspects of your new business, or if you have questions about reporting or recordkeeping requirements, please contact us.