

Important Tax Information For Independent Contractors

Being your own boss is certainly rewarding, but few people think about the extra work of preparing invoices and tax forms. Independent contractors need to be aware that being independent of the client company is a special tax situation, and they will need to file differently with Internal Revenue Service than they might have in the past. **What is an Independent Contractor?** Those who work regularly for the same clients or who only contract under one company might wonder if they are just an employee. Generally, independent contractors do not participate in the same programs and activities as the rest of the employees do and are not subject to the same restrictions. Those who are starting a job should define their obligations with the clients and make sure the client will be listing them as an independent contractor in tax forms. If the company pays the contractor more than \$600 over the course of a tax year, they will be required to send him or her a 1099 form. These lines start to blur when the contractor spends much of their time in the office or conferring with employees on the project. If the employer labels the contractor a common-law employee and sends them a W2 by mistake, the individual can file Form SS-8 to dispute the classification. The IRS defines an independent contractor using the "20 Questions" test, which looks at a number of factors including the amount of control the hiring company has upon their work. According to them, an employer "has the right to control or direct only the result of the work and not what will be done and how it will be done or method of accomplishing the result." For tax purposes, however, an independent contractor is a business. Most will fall under the category of sole proprietorship. However if the contractor employs others or is incorporated, their status may change. Another option might be to run your business through an "umbrella company" or so-called "pass-through agency," which can give the option of being either a W-2 or a 1099 for tax purposes, and this can be a great option to simplify the back-office administration that independent contracting requires. There are benefits to all of the tax business classifications, but business owners should do research on which one best fits their organization. **Self-Employment Tax** When someone who is an employee receives a W2, income and social security taxes are already taken out of their paycheck and sent to the IRS by the employer. Those who receive 1099 forms do not have any taxes removed from their wages by an employer. The self-employed individual must file their income and pay self-employment tax. Any individual who makes more than \$400 from freelancing or independent contracting work must file a 1040 Schedule C form with the rest of their taxes. This form will help the individual calculate how much tax they owe. The federal self-employment tax rate is 15.3% but it can vary depending on how much income the person has earned and their deductions. Deductions are business expenses that can be deducted from the gross income. See the IRS website for more information. The calculated tax must be paid to the IRS. If the tax is likely to be more than \$1000, see estimated tax payments below. If the tax is less than \$1000, the business owner may pay the owed tax at the end of the year upon completing their tax return. If the business is a sole proprietorship and the business owner does not have a social security number, they will need to file for an Individual Taxpayer Identification Number or ITIN in order to submit their taxes. **Estimated Tax Payments** Businesses that anticipate owing more than \$1000 at the end of the tax year are required to make quarterly estimated tax payments. Using an estimation of their income for the year, the business completes worksheet 1040-ES and sends in one fourth of the amount on each deadline. Payments can be made electronically via credit card or automatic withdraw. The IRS still accepts check and money orders by mail as well. The payment deadlines generally fall in April, June, September, and January, but can vary by tax year. If the business miscalculates their income, the end of year filing will be adjusted. Unpaid tax will be added, and those that overpaid will receive refunds. **State Tax** Most U. S. states have separate state income tax laws. Filing procedures and rates vary widely from state to state. Those who own a business should investigate their local tax code for more information. **Obligations of the Self-Employed** Independent contractors should keep excellent records to make the process of filing taxes easier. Receipts and invoices should be kept for reference, but also stored for use in case of a future audit or tax dispute. Tax code is complicated and ever changing, so make sure to look up the new tax rules for each filing year. Those with complicated finances may want to hire a professional advisor to check or prepare the tax forms as they can prevent costly mistakes.

About the Author

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