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Self-employed tax deductions: You may qualify for tax write-offs for starting a business

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The Great Resignation may be creating a tax headache for a lot of people.

Last year more than 47 million people quit their jobs. In the same year, a record 5.4 million new business applications were filed, according to Census Bureau data.

From a tax perspective, it is much simpler to be a salaried worker than to be self-employed. As a salaried worker, your employer files a W-2 form on your behalf. It’s a record of how much money you earned, taxes withheld from your paycheck and pretax contributions you’ve made to such things as a retirement account and health insurance.

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“All that is pretty much on a silver platter for the vast majority of employees,” said Jay Soled, a professor and director of the master of accountancy in taxation program at Rutgers University. From there, it’s a relatively easy process to file your income tax return, aside from other areas such as investment income.

But when you’re self-employed, it’s a whole different ballgame.

It’s even more complicated for Americans who were a combination of the two last year.

But Lisa Green-Lewis, a CPA and tax expert with Turbo Tax, said it's manageable.

Forms to file self-employed taxes

Essentially, you'll be filing a longer tax return for 2021 that covers your income as a W-2 worker and self-employed worker, as well as any other income you earned.

If you became self-employed at some point last year, you should have already paid at least one quarterly estimate of the taxes you owe. In general, you're required to pay an estimate each quarter or face a penalty.

But you also must use a Schedule C form to document the income or loss your business experienced last year. Next, you must fill out Schedule SE, which is how much you owe in self-employment taxes.

What is the self-employment tax rate for 2021?

All workers are required to pay a 15.3% tax on income that funds Social Security and Medicare. As a W-2 employee, you're responsible for only half of that. Your employer pays the other half.

Self-employed workers must pay the full 15.3%, but only for the first $142,800 of net income, meaning what you earned minus any tax deductions for which you may qualify. Above that threshold, you're required to pay only an extra 3.9% tax on your earnings.

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And in general, 92.35% of your net earnings is subject to self-employment tax.

For example, if you reported a net profit from being self-employed of $100,000, $92,350 of your earnings would be subject to the 15.3% self-employment tax. So you'd pay $14,129.55 in self-employment taxes.

You can also deduct half of what you paid in self-employment taxes from your adjusted gross income, which is the taxable portion of your income. In the prior example, you'd be able to deduct nearly $7,065 from your gross income. So if you end up under the 25% tax bracket, you'd save around $1,766 in income taxes.

Self-employed tax deductions and write-offs

The tax major advantage of becoming self-employed is that you can qualify for a wide range of deductions. For instance, you may be able to deduct part of rent or mortgage payments if you work from home, on top of other home office expenses for which regular employees don’t qualify. You can also deduct your health insurance costs.

TurboTax has a free Self-Employed Expense Deduction Interactive that can help you identify self-employed business expenses related to your specific industry.

“Tax filers who start their own business shouldn’t worry about the taxes on their self-employment income because there are so many ways to lower their net self-employment income,” said TurboTax’s Greene-Lewis.

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To take advantage of them you must be meticulous about maintaining a record of all your business expenses throughout the year, said Stephen Fishman, a tax lawyer based in Olympia, Washington. “If you don’t have that, you can try to reconstruct a record using your credit card and bank statements,” said Fishman, who has written 20 books on tax law including “Tax Deductions for Professionals.”

Along those lines, Soled, the Rutgers professor, recommends having a separate business bank account so you can “keep an accurate ledger of what you’re doing for business purposes versus those which are personal in nature."

“Many self-employed people actually pay less tax than employees who make the same income because they have all these deductions,” he added.