



Freelancer Tax Tips

Taxes You May Owe

Things get a little more complicated when you are in business for yourself. Stay on top of some of the basics below.

1. Self-employment Taxes—15.3%

- Self-employed individuals are liable for both the employee's and employer's share of FICA (Social Security and Medicare) taxes.

2. Estimated Taxes

- Do I owe them?
 - Generally, if you had a tax liability in the prior year and you expect to owe \$1,000 or more in the current year, you will owe estimated taxes.
- What happens if I don't pay estimated taxes?
 - If you do not make estimated tax payments when you are required, you will be penalized.
- When do I make estimated tax payments?
 - The IRS expects you to pay 25% of your tax liability each quarter (due dates are typically: 4/15, 6/15, 9/15, and 1/15). Penalties may apply if you do not make timely quarterly payments, even if you are due a refund when you file your taxes.
- How much should I pay?
 - Safe Harbor Rule. This rule protects you from owing a penalty if you pay at least 90% of the current tax year's liability OR 100% (110% for higher-income earners) of the prior year's tax liability throughout the year via withholdings or *timely* estimated tax payments (payments by quarterly due dates).
 - **Note:** While the Safe Harbor rule protects you from owing penalties, you may still owe taxes at the end of the year if your income is higher than initially projected. It is always a good idea to periodically revisit your projections throughout the tax year to ensure you're not stuck with a large tax bill in April. See form 1040ES.

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DISCLAIMER: Any accounting, business or tax advice contained in this communication, including attachments and enclosures, is not intended as a thorough, in-depth analysis of specific issues, or a substitute for a formal opinion, nor is it sufficient to avoid tax-related penalties. If desired, we would be pleased to perform the requisite research and provide you with a detailed written analysis.

- What if my income is variable or unpredictable?
 - If your income is unpredictable or seasonal, the IRS offers a different methodology and worksheets to calculate estimated taxes. See Form 2210 and Publication 505.
- Where do I make estimated tax payments?
 - You can pay via mail (see instructions in Form 1040ES) or online at <https://www.irs.gov/payments/direct-pay>

3. Other Common Taxes

- State Income Taxes—You may be liable for income tax in other states if any income is sourced from states other than TN (assuming you are a TN resident)
- State Sales and Use Taxes
- TN State Business Tax
- TN State Franchise and Excise Taxes—Does not apply to Sole Proprietors or General Partnerships

TN Sales Tax—TN state rate 7% + local rate varying from 1.5%-2.75% (Note: You may be liable for sales taxes in other states if you are selling taxable goods or services to people outside of TN).

- Applies to sales of tangible personal property, certain taxable services, and specified digital products.
- Remember that you are liable for sales tax, even if you choose not to collect it from your customers.
- The “sales price” includes cost of property sold, shipping charges billed to the buyer, as well as installation charges, cost of material, labor, or service cost (if you are creating, installing, or servicing tangible personal property).
- 9.5% flat rate applied to specified digital products (i.e. digital audio-visual works (i.e. films and videos), digital audio works, and digital books).
 - Not included within definition of digital books: newspapers, magazines, periodicals

TN Use Tax

- You are liable for use tax when purchasing items for use or consumption in your business in the following situations. The amount of use tax you owe is the difference between the amount of sales tax you actually paid and the amount of applicable TN sales tax you should have paid.
 - You purchase the item from a seller in TN and they do not charge you sales tax.

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- You purchase an item from a seller in another state and they do not charge TN sales tax or you pay sales tax, but at a rate that is less than the applicable rate you would pay in TN.

Business Tax

- Most service-based businesses fall under Classification 3. Classification determines your tax rate. Some services are exempt.
- The tax is based on taxable gross sales less certain deductions.
- There are two returns, one for county and one for municipality; the combined rate for both returns under Classification 3 is .00375 (3/8 of 1%).

Am I at Risk for an Audit?

- Two percent of returns for Sole Proprietors filing a Schedule C are audited, which is **7 times higher** than the audit rate for Partnerships, LLC's, and S-Corps.
- Taking deductions is a great way to reduce taxable income, but make sure to report the following items accurately on your tax return. These deductions are more closely scrutinized and could raise a potential flag for an audit.
 - Home office deduction, business travel, meals and entertainment, and listed property (i.e. vehicles, computers and peripheral equipment, and property generally used for entertainment, such as photographic, phonographic, communication, and video-recording equipment.)
- Amended returns are more likely to be audited. File your return correctly the first time!
- If you think there are items on your return that might raise a flag for an audit, submit plenty of clear documentation when filing to help support your position.
- If you feel uneasy or over your head when preparing your tax return, you may want to consult with a professional.

Protect Yourself from an Audit

1. Make sure to report ALL of your income, even if you didn't provide an invoice to someone or they didn't provide you with a 1099. The IRS can subpoena your bank records and can easily locate sources of income you didn't report, especially in this day and age of electronic payments.
2. Business Expenses. While there are many different rules surrounding business expenses, remember that in every case it must be **ordinary** (common and accepted in field of business) **and necessary** (helpful and appropriate) to be tax deductible.
 - Don't be afraid to take deductions you qualify for though. While there are exceptions, many expenses related to your business can be deducted. Different expenses qualify depending on what type of business you are in. For instance, if you are an artist, you might be able to deduct a museum membership. If you are a food critic, dining out could be research for your job!

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3. Open a separate bank account and credit card account for your business. Taking this extra step not only results in cleaner records that show the IRS you are trying to do things correctly, but it also makes assessing your financial performance much easier and tax time less of a burden.
4. There are many no or low cost options for accounting software on the market today. Many are cloud-based and offer options to use on mobile devices and integrate with apps. Graduating to an accounting system is a big step in the right direction to help manage your financial performance, monitor cash flow, budget, and improve efficiency and recordkeeping.
 - Easily upload receipts, make notes on transactions, reconcile bank statements.
 - Review your bottom-line and trends.
 - Electronic storage of records is fine, just make sure scanned copies of receipts, etc. are legible and backed-up in the event your computer crashes.

Useful IRS Publications to Reference for Freelancers

- Publication 505 – Tax Withholding and Estimated Taxes
- Publication 583 – Starting a Business and Recordkeeping
- Publication 334 – Tax Guide for Small Business
- Publication 535 – Business Expenses
- Publication 463 – Travel, Entertainment, Gift, and Car Expenses
- Publication 587 – Business Use of Your Home
- Publication 946 – How to Depreciate Property

More questions or concerns? We'd be happy to talk. We offer free 30-minute consultations for potential new clients. Contact us today at info@polaristaxes.com or 423.521.5882 if you are interested.