# Your Taxes: If You're a Freelancer

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*Hey there, this story refers to the 2011 tax year. For the most up-to-date information covering the 2012 tax year, check out How to Do Your Taxes if You're a Freelancer.*

You're free! Free to sleep in until 11 a.m., free to work while your adorable toddler plays at your feet, free to … keep really good records of all your expenses for your taxes.

We know. Not so fun. The reality is, being self-employed can be awesome for 11 months out of the year, and then come crashing down on your head in the form of lost receipts and unpaid estimated taxes in April. We want to save you from that sinking feeling. Read on for what every freelancer needs to know for your taxes.

## Get Organized

First, keep organized records. Go paperless, get organized and keep track of two things:

**1. Your business income.** This is your responsibility, and it is a big one. The IRS is especially sensitive about freelancers fudging their income. Yes, you will receive 1099 Forms from clients with what you earned, but only for jobs worth more than $600. So make sure you have a good recording system, like a "Freelance Income" folder in My Money Center.

**2. Your business expenses.** You don't want to miss out on deductions related to business expenses, so carefully record what you spent, the date, who you paid it to and the purpose for expenses such as:

- Business cards, online ads and other tools used to promote yourself and your business
- Business insurance
- Interest paid on your business credit card or business loans

- Lawyer fees and other professional services
- Rent or dues on a workspace
- Repairs for your computer, camera and other business-related equipment
- Routine office supplies like pens, paper, staples, etc.
- Travel costs like plane and train tickets
- Business meals with clients and other entertainment reasonable for your business

## Find the Right Tax Preparer

We'll be straight with you. Taxes for freelancers are complicated, so we recommend you invest in a tax preparer. Look at it this way: You could pay about $300 to get your taxes done, and an accountant could easily save you $300 in fees, deductions you hadn't heard of and more.

If you decide to pay for a tax preparer, make sure they are familiar with all the ins and outs of self-employment taxes. It's best to find one that specializes in self-employed individuals and is available throughout the year if you have any questions.

## Pay Quarterly Estimated Taxes

When you work full-time, you have your estimated taxes automatically withheld from each paycheck. But when you are a freelancer, you may be responsible for paying your estimated taxes every quarter, by the 15th of every April, June, September and January, for the previous tax year.

This is actually better for you, because it's easier to pay your taxes in small chunks instead of in one big wallop in April. If you *don't* file and pay quarterly, the IRS will charge you fines and penalties.

File your estimated taxes by using IRS form 1040-ES, and plan on paying 15.3% of your income every quarter. We suggest setting up a separate savings account where you can park the money until you pay. To make the process of paying smoother and faster, sign up with the Electronic Federal Tax Payment System.

## Use These Forms

### Fill It Out as a Freelancer: W-9

If you're self-employed, clients or companies that hire you as a contractor might ask you to fill this out when you take the job. It asks for your name, address, Social Security Number and maybe your tax identification number if you are part of a company that's been contracted.

### Get This From Your Clients: 1099

If you're self-employed, clients or companies that hire you as a contractor and/or freelancer might send this to you before the tax filing deadline. It's a summary of money they've paid you, which is the amount that you need to pay taxes on. You will only receive this form if the client paid you more than $600. If you were paid less, you won't get a form, but you must still report that income (see below).

### Fill Out Your Taxes On: 1040

Because you are reporting self-employment income, you will be using the original 1040 form, instead of the 1040A or 1040-EZ form. Learn more about the different types of 1040s.

### For Filing Simple Freelance Taxes: Schedule C-EZ

If you're a freelance graphic designer or writer, you have a pretty simple business and can use a simplified form instead of the Schedule C, below.

**Use this form if:**

- Your business expenses are less than $5,000
- You have no employees
- You have no inventory (sorry Etsy sellers, you need the more complicated form, Schedule C)
- You are not using depreciation or deducting the cost of your home

### File Business Taxes: Schedule C

Schedule C addresses taxes specific to your business.

### Estimate Your Taxes: Schedule SE

This is the form you'll use to estimate your taxes for the year; file this with the IRS.

### If You Had Capital Gains and Losses: Schedule D and Form 8949

These forms are used to report capital gains and losses. This is when you sold investments for more or less than what you paid for it. Because the rules governing these forms are very detailed and specific, make sure to read the IRS instructions if you think any of these circumstances might apply to you. Find instructions on the IRS website.

**Use these forms if:**

- You had a gain or loss from a partnership, S corporation, estate or trust
- You sold assets from your business
- You made a gain or loss on other assets, like futures contracts, etc.

## Look for These Deductions

### Business Expenses

The self-employed can deduct business expenses that qualify, such as those mentioned at the beginning of this post. Overall, these expenses should be:

**1. A generally accepted part of doing business in your industry.** For example, a laptop if you are a writer, or business meals with clients if that is how clients are generally treated in your line of work.

**2. Helpful and appropriate for your business.** They don't have to be indispensable, but should help you perform better in your business.

You can learn more about what makes an appropriate deduction for your business on the IRS website.

### Health Insurance

If you pay for your own health insurance, you can deduct the full cost on your 1040 as a personal expense. If you made a profit, you deduct it as an above-the-line deduction on line 29 of your 1040. If you did not make a profit on your business, it will be a below-the-line deduction, as a medical expense. Then you must itemize in order to claim it.

### Home Office

As a freelancer, you may do the majority of your work out of your home. That means you might be able to deduct the cost of your home office. (But watch out, this is a common audit trigger–see below.) You'll use Form 8829 to calculate and claim this deduction. Just be aware you cannot claim an office deduction that is more than your net profit for the year. If your home office is worth more than your net profit, then you can carry the extra over to the next year.

### Business Assets

These are different from business expenses, as they will be used over several years. Did you buy Photoshop, a computer or office furniture? These are all business assets. You'll have to decide whether you would like to deduct the full cost in the year you bought them, or spread the cost out over the lifetime of the asset, which is called depreciation. A tax preparer can help you with all the hairy details, but here's the short version of how to decide: Spread the cost out if you think you will be making more income in the future, or deduct them now if you had high income this year.

## Watch Out for These Audit Triggers

As a freelancer or business owner, there are certain things you may do on your return that will trigger an audit. Here are the most common ones to watch out for:

### Reporting the Wrong Taxable Income

You can't lie about your taxable income, because both you *and* the IRS received your W-2 and 1099 Forms, for both full-time employees and self-employed individuals.

**Perfectly OK:** Making a small math error. The IRS will correct that.

**Not OK:** Estimating or fudging how much you've made**.**

**The Proof You Need:** Compare the 1099 or W-2 you receive from the company against your own records. If you think it is wrong, inform the company and ask that they file a corrected 1099 or W-2 with the IRS.

### A Steak Dinner With the Clients

Rules for claiming this are strict, so it's a smart idea to read up on them before trying to make the government pay for your nights out on the town.

**Perfectly OK:** Deducting 50% of the cost of a reasonably priced meal where you entertained potential clients for your business.

**Not OK:** Deducting the cost of a lavish steak dinner with rare champagne as entertainment, and then trying to deduct it again as a travel expense. To see more instances, read this publication from the IRS.

**The Proof You Need:** Keep all receipts, and record the dates and times, description of the expense, the business purpose and business relationship. More details are here.

### Using Your Car for Business

Sure, a lot of people use their cars for some part of their business. But if you're also using it to shuttle kids to lacrosse practice, it just doesn't qualify.

**Perfectly OK:** The car is used solely for delivering wedding cakes to your clients.

**Not OK:** Sometimes you drop off deposits at the bank on your way to getting your nails done.

**The Proof You Need:** Keep a record of your mileage, and keep calendar entries specifying your starting and ending addresses. Detail the purpose on your calendar every time you use the car for business.

### Your Home Office

A lot of people think they can stretch the definition of a home office, which is why claiming it could trigger an audit.

**Perfectly OK:** A study where you keep your computer, phone, bookshelves and other supplies for work, and where you do the majority of your work and that is not used for any other purpose, especially personal use.

**Not OK:** A desk with a computer in the corner of your living room or guest bedroom where you work for a few hours a week.

**The Proof You Need:** If you want to take this deduction, make sure to read IRS Publication 587. It is very detailed, and even includes a semi-fun (well, sort of) flow chart to make sure you're on the up-and-up.

### A Business That Loses Money

It's not ideal that your business loses money. (That kind of misses the point, right?) If the IRS sees someone who has a full-time business, and in more than three years out of the last five loses money, it will make them look closer.

**Perfectly OK:** Things didn't go well with your business this year or last year, and you took a loss.

**Not OK:** You have an expensive, full-time hobby like owning a vineyard or fixing up antique bicycles and you're not even trying to make a profit.

**The Proof You Need:** You should have all the proper documentation as if it were a business, and prove that it made a profit for three out of five years.

Learn about other audit triggers.

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