Wise CPA Group
Accountants and Consultants

7235 N. Western
Chicago, IL, 60645
T. 773.262.0470/F.773.262.4457
Info@wisecpagroup.com

Self-Employment Tax; Double Taxed

August 14, 2014

Now comes from out of left field, for those individuals who are self-employed; Self-Employment tax. In addition to federal and state income tax, is a 15.3% tax based on the net earnings of the self-employed individual up to $117,000 for 2014. If you were a W2 employee, these taxes would have been deducted from your gross pay as separate line items for Social Security and Medicare at 6.2% and 1.45%, respectively. Since becoming self-employed, the employer, now you, incurs an extra tax of having an employee: you. The additional taxes are a mirror image of the separate line item deductions for Social Security and Medicare costing the employer, you, another 7.65%.

There are numerous advantages of being self-employed versus being an employee, mainly being able to deduct your business expenses from business revenue. Business deductions such as auto mileage, equipment, supplies, rent, and office expenses are some of the eligible deductions a self-employed individual can claim on his/her Schedule C.

Notably, the self-employed individual should be making quarterly tax payments if expecting to owe at least $1,000 for the current year in order to prevent penalties and interest. Safe harbor rules do apply if the individual pays at least 90% of the current year's tax prior to filing or paid 100% of the prior year's tax. The payments should be made using Form 1040 ES and submitted April 15th, July 15th, October 15th, and January 15th.

The self-employed U.S. citizen residing outside the U.S. may claim the foreign earned income exclusion on the net Self-Employment income on Form 2555; however, this will not eliminate the SE tax owed on the income. The individual may be paying into that country's social security system as well, in which case the SE tax does not wash away and the U.S. citizen/resident can effectively be double taxed. The U.S. is aware of this issue, and to remedy this dilemma, currently, the U.S. has social security agreements (also known as Totalization Agreements) with the following 25 countries, thereby eliminating double coverage: Italy, Germany, Switzerland, Belgium, Norway, Canada, United Kingdom, Sweden, Spain, France, Portugal, Netherlands, Austria, Finland, Ireland, Luxembourg, Greece, South Korea, Chile, Australia, Japan, Denmark, Czech Republic, Poland, and Slovak Republic.

Self-employed individuals residing in 1 of the 25 aforementioned countries under an agreement must document their exemption by obtaining a certificate of coverage from the country that will continue to cover them.

International Social Security agreements are advantageous both for persons working now and for persons retired, disabled or the estates of persons deceased. For current workers, the agreements eliminate the dual contributions they might otherwise be paying to the Social Security systems of both the United States and another country. For persons who have worked both in the United States and abroad, and who are now retired, disabled, or deceased, the agreements often result in the payment of benefits to which the worker or the worker's family members would not otherwise have become entitled.

If you would like to discuss this or any other U.S. tax or accounting matter, please feel free to call Gabriel at 773.269.6513 or email Gabriel.wise@wisecpagroup.com.

We look forward to hearing from you.

Gabriel Wise, CPA MST