5 Tax Tips for Small Business Owners and Freelancers

As the old saying goes: "The only two things certain in life are death and taxes."

And tax time is upon us, with the April 15 deadline quickly approaching – and that's certainly no April Fools!

No matter which "side of the aisle" you fall on politically, there's no doubt the middle class gets ***squeezed*** with the highest effect tax rate relative to gross income earned. And most small business owners and freelancers are part or the middle class designation.

In short, the more you know about the ins and outs of the tax code, and all the tips and tricks for effectively navigating this often cumbersome process, the less money you'll end up having to fork over to Uncle Sam, and more cash you'll keep in your pocket (where, frankly, it belongs).

Here are some important tips to help best manage your finances for tax purposes as a small business owner or freelancer. (Some of these tips may not help you in this year's round with the taxman, but are definitely applicable in the future.)

Keep Adequate Records

One of the biggest issues tax professionals are harping on this year is **record keeping.**

Most state governments are broke and running enormous deficits. Meanwhile, the federal government is running the biggest deficit in the nation's history (and it's growing daily). So the taxman is hungry for CASH! And individuals filing taxes with self-employ status immediately arose suspicion.

So, if you want to avoid being audited (which is definitely no fun) KEEP DETAIL RECORDS!

In fact, if you don't already have one, download and review the 1040 tax form Schedule C. And then outline your deductions. It's definitely a good idea if you want to stay on a straight and narrow path (to NOT getting audited).

Business Income vs. Business Losses

One of the biggest benefits of being self-employed is your ability to deduct your business expenses from you gross income, effectively lower you taxable income. On the other side of this coin, however, self-employed individuals with high wages offset by inordinately high business loss represent one of the biggest red flags for those filing taxes with self-employed status.

Freelancers calculate profit with the following equation: income – expenses = profit. And it's not uncommon for freelancers to show a loss. But if your income is high (especially if it's above average for your profession – and rest assured the IRS is well aware of the average), and you're attempting to reduce that income with extraordinarily high business losses – you're headed for trouble.

Another issue to avoid is showing a business loss year after year. If a business shows a loss 3 out 5 years, the IRS can audit you to investigate whether or not you're conducting a "hobby" as business to just incur business losses as strategy to reduce your overall income and lower your tax-base.

Obviously you have to be aggressive with your tax return to avoid as much taxation as possible. But be careful, as you might be inviting the attention you would rather avoid.

Self-Employment Taxes

The biggest difference between filing taxes and an employee and a self-employed individual is employment tax.

When you're an employee, your employer matched half of what the government refers to as your "employment taxes." This includes: Social Security, Medicare, etc… When you're self-employed, however, you're solely responsible for those so-called "employment taxes," which are referred to as "self-employment taxes."

Self-employment taxes generally amount to about 15% of your gross income (up to $100,000). Ideally you should set aside this amount and pay quarterly estimated returns.

By reducing your effective gross income with deduction, however, you can reduce your employment tax, and that brings us to our next tip…

Deductions

The following are list of typically acceptable deductions for a freelance welder under Schedule C of the 1040 Tax form:

Advertising – this includes all aspects of marketing and advertising, including business cards, brochures, flyers, direct mail, print ads, website site design and hosting
Insurance – for life, property & casualty, or business insurance (do not include health insurance under this category.)
Other interest – credit card or loan interest, such as interest paid on construction equipment loans.
Legal and professional services – Attorneys and accountants fees

Employees – if you have employees, employee compensation and benefits (including health insurance)
Administrative expenses – billing and invoicing services.
Rent or lease other business property – rent paid for an office, store front, storage space, etc…
Repairs and maintenance – repairing any equipment necessary to run your business, or maintaining your store or office
Supplies – inventory, supplies to run your story, computer equipment, office supplies, etc…
Travel – the cost of gas and wear on your car when traveling to and from your place of business or to meet clients
Utilities – electricity, gas
Other expenses – such as professional organization membership dues, chamber of commerce dues, business telephone and internet expenses

Health Care Costs

Health care premiums are deductible on your 1040 tax form as personal deduction; unless your business showed a loss. In that case your premium has to be deducted on the Schedule A form as a medical expense.

Registering as an S-Corp

This tip is a little too late to help with this year's taxes, but may be a prudent measure for the future.

An S-Corp is a special kind of incorporation designation for small businesses or self-employed individuals. Chiefly, it offers the personal protection of a corporation. Your personal assets are protected from the legal liabilities your company is subject to. It also relieves your of personal responsibility for business debts and losses.

The corporation doesn't pay taxes. Instead the taxes "pass-through" to the corporate officer – you – and pay taxes as you would normally.

Establishing an S-Corp is less a tax exemption and more measure to protect your assets and reduce your legal liability.

If you gross less than $100,000 annually, an S-Corp probably doesn't make sense for you. This is because you have to file personal and corporate tax returns.

Legal Zoom is an excellent resource for no-hassle incorporations, business registrations and DBA filings.