Taxes for Contractors

A contractor, or freelancer, can be anyone who works for clients on a contract basis rather than as an employee. Being a contractor can mean flexible hours, getting to choose your projects, and getting to work with multiple clients. But it can also mean a few extra headaches come tax season.

Whether you’re an employee or a contractor depends on how you get paid and what tax forms you receive at the end of the year. If you’re paid through payroll and receive a W-2 form in January, then you’re an employee. If you submit invoices for your work and receive one or more 1099 forms at the start of the year, then you’re a contractor.

Key differences

If you’re a contractor, there are a few key ways your taxes will differ from an employee’s:

* The good: As a self-employed worker, you can claim business expenses on your taxes that employees can’t.
* The bad: Thanks to the self-employment tax, even after those deductions you’ll probably end up paying tax at a higher rate than your friends with office jobs.
* The ugly: You might want to put the IRS helpline on speed dial because your taxes are going to be complicated.

What you’ll need

Whether you file online, hire an accountant, or do it the old-fashioned way with a calculator or a spreadsheet, you’ll need the following:

* A 1099 form from each client
* Records for all your work-related expenses and other deductions for the year
* Tax documents for any investment income or financial accounts
* Records for any additional income you received during the year

The basics on deductions

Chances are you’re familiar with the general idea of deductions: They’re amounts that reduce your taxable income, which, in turn, reduces the amount of tax you owe. If you have $50,000 in income and $10,000 in deductions, then you owe taxes on only $40,000 of your income.

Everyone has to choose between taking the standard deduction and itemizing deductions. If you itemize, you’ll need to add up lots of smaller individual deductions, such as deductions for interest paid on a home mortgage and for charitable donations. By contrast, choosing the standard deduction means you get to reduce your taxable income by a set dollar amount.

For some people, the standard deduction represents bigger savings, while others save more by itemizing.

Walk the line

As an independent contractor, you can take business deductions that employees can’t—and you can take these even if you don’t itemize your deductions. In tax lingo, that’s because business expenses (and some other “personal deductions” that are specific to contractors) count as “above-the-line” deductions—in the flow of a tax return, they reduce your adjusted gross income.

Your total business income

↓

Minus business deductions

↓

Plus any other income you earned

↓

Minus any personal deductions for self-employed workers

↓

Adjusted gross income (“the line”)

↓

Minus either standard or itemized deductions

The main takeaway: You can (and almost certainly should) deduct your business expenses even if you don’t itemize.

Those business deductions can include:

* The costs of running your home office
* Expenses for work-related equipment or technology
* Travel, meals, and lodging costs for business trips
* Education and training expenses
* Dues to professional organizations
* Other miscellaneous expenses

Additional personal deductions for self-employed workers may include:

* Health insurance premiums
* Contributions to qualified retirement plans
* Half of your self-employment tax (see below)

Consider tracking these expenses throughout the year so that you’re well-organized come tax time.

Good to know

* If one of your clients didn’t send you a 1099 form, you still need to report that income.
* If you travel a lot for work, you may owe taxes in multiple states in addition to your federal taxes.
* The self-employment tax covers your contributions to Social Security and Medicare.
  + Employees get to split this tax with their employers—with the employer paying 7.65% and the employee paying 7.65%.
  + As a contractor, you’re responsible for paying the full 15.3%, but you get to deduct half of that amount (the “employer half”) as a business expense.
* As a self-employed worker, chances are you need to make quarterly estimated tax payments during the year.
* Starting with the 2018 tax year, you may also be able to deduct 20% of your business income, depending on the details of your tax situation.

Key takeaways

* An independent contractor is someone who is self-employed and may work for multiple clients on a contract basis.
* Independent contractors can have complex tax situations in part because they typically qualify for more deductions than employees.
* If you’re a contractor, you can generally deduct business expenses on your taxes even if you take the standard deduction.
* Keeping track of your work expenses throughout the year can help you make the most of your business expense deductions.
* If you’re a contractor, you should also become familiar with the self-employment tax, filing quarterly estimated taxes, and the rules that apply to each state you work in.