Self-Employment Tax

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Rural Tax Education

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  • Treatment of Government Payments
  • Farm Losses and Hobby Rules
  • Self-Employment Taxes
  • Estate and Gift Taxes
  • Like Kind Exchanges
  • Depreciation
  • Etc...
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Self-Employment Income

- Earned Income from a Trade or Business
  - Farm Business
  - Non-Farm Business
  - Services provided is earned income
- Rental Income if material participation exists
  - Crop Share with material participation
Computation

• Net Farm Income
  • Only 92.35% is subject to SE Tax at 15.3% rate
  • Social Security: 12.4% of 147,000 of earnings (2022)
  • Medicare: 2.9% of earnings
  • Additional Medicare Tax on net SE on earnings in excess of $250,000 MFJ ($200,000 single)
• If profit < $400: no SE Tax is due
• $\frac{1}{2}$ of SE Tax is allowed as a deduction on 1040
Example Computation

1. Net Farm Income = $100,000 (below $147,000 limit)
   • $100,000 x 92.35% = 92,350
   • 92,350 x 15.3% = $14,130 total SE Tax

2. Net Farm Income = $150,000 (above $147,000 limit)
   • $147,000 x 92.35% = 135,755
   • $135,755 x 12.4% = $16,834 Social Security portion
   • $150,000 x 92.35% = $138,525
   • $138,525 x 2.9% = $4,017 Medicare portion
   • $16,834 + 4,417 = $21,251
Farm Employees

- Generally must withhold Social Security and Medicare tax on cash wages paid and pay the employers portion (7.65 for employee and employer)
- Two tests
  1. $150 or more of cash wages to employee, or
  2. $2,500 or more of total wages paid to all employees
Family Employees

• Children who work for you
  • Under 18 years old; are not subject to either social security or Medicare taxes
  • 18 and older; are subject to both
• Spouse who works for you
  • Subject to both social security and Medicare taxes
(Neither subject to Federal Unemployment Tax)
Why Paying the SE Tax is Important

• For small farms the SE Tax bill is often larger than the income tax due
  • SE Tax Rate = 15.3%
  • Income Tax Rates = 10, 12, 22, 24, 32, 35, and 37%

• Paying SE Tax provides
  1. Retirement (Old Age) benefits
  2. Survivor benefits
  3. Disability Insurance
To Receive Benefits

- Must meet recent work and duration of work tests to qualify for benefits
  1. Recent work test: disability and survivor benefits
  2. Duration of work test: retirement benefits
- Benefits are based on the number of credits earned
- For 2022, one credit is earned for each $1,510 of net earnings
- $6,040 of earnings needed to obtain the maximum four credits of coverage for the year
Credits Needed

Social Security Disability and Survivor Benefits

• Recent work test
  • 31 and older: must have 20 credits and work 5 years
  • Younger: 1.5 years of work during a 3 year period
• Duration of work test
  • 27 and younger: 1.5 years of work required
  • 62 and older: 10 years of work and 40 credits
  • 28 to 62: years of work and credits needed vary
Credits Needed

Social Security Retirement Benefits

• Age 62 or older
  • Benefit based on requirement of 40 quarters of coverage
  • Benefit amount looks at the largest amounts paid in for those 40 quarters
  • Farmers and ranchers often have years where no SE tax was paid (losses or very little taxable income)
• Age 62 but less than full retirement age
  • Benefit is reduced depending upon age at retirement
Agriculture Issues

• Farmers and Ranchers hate to pay taxes
• Income variability is a major problem
  • Years of low income
  • Years of losses
• Desire to grow the business (reinvest income)
• Desire to invest in new/improved technology
• Result is not having enough paid into Social Security to be able to retire
Optional Method for SE Tax

Benefits for Paying
• Disability Benefits
• Survivor Benefits
• Retirement Benefits
• Increase or qualify for
  • Earned Income Credit
  • Additional Child Credit
  • Child and Dependent Care Credit
  • Self-employed Health Insurance Deduction
Farm Optional Method

- Used to Calculate Net Earnings for SE Tax
- Requirements to use
  - Gross Farm Income of $9,060 or less
  - Net Farm Income must be less than $6,040 (2/3 of $9,060)
- Can result in earning up to 4 quarters of coverage, even in a low income or even years with negative net farm income
Examples: Farm Optional Method

Gross Farm Income less than $9,060
- $6,000 of gross farm income and a net loss
- If elect to use the optional method, report 2/3 of $6,000 as earnings from self-employment ($4,000)
  - SE Tax = 15.3% x 4,000 = $612
- 2 quarters of coverage are earned ($4,000 of reportable earnings ÷ $1,510) for benefits
Examples: Farm Optional Method

Gross Farm Income more than $9,060 and net farm income is less than 2/3 of $9,060 ($6,040)
- $12,000 of gross farm income and $5,000 of net farm income
- If using the regular method, SE Tax = $706 and receive 3 quarters of coverage ($5,000 ÷ $1,510)
- If elect to use the optional method, report $6,040 as earnings from self-employment (4 qtrs. = $6,040)
- SE Tax = 15.3% x 6,040 = $924
Farm Optional Method

• Ensures that farmer qualifies for retirement, disability, and survivor benefits if the quarter of coverage requirement is met
• Can be used as many times as needed since no limit on the number of years that it can be used
Full Retirement Age

Individual can draw full retirement benefits at the following ages

- Born in 1937 and earlier, reach FRA at age 65
- Born in 1943 to 1955, reach FRA at age 66
- Born in 1960 or later, reach FRA at age 67
## Earnings Limit 2022

<table>
<thead>
<tr>
<th>Age</th>
<th>Income</th>
<th>Withholding</th>
</tr>
</thead>
<tbody>
<tr>
<td>Under Full Retirement Age</td>
<td>$19,560</td>
<td>For every $2 over the limit, $1 is withheld from Social Security benefit</td>
</tr>
<tr>
<td>In the calendar year full retirement age is attained</td>
<td>$51,960</td>
<td>For every $3 over the limit, $1 is withheld from Social Security benefit</td>
</tr>
</tbody>
</table>
References

- IRS Publication 225, Farmer’s Tax Guide
- Social Security Administration https://www.ssa.gov
- www.RuralTax.Org  Select Tax Tips
  2. The Optional Method of Paying Self-Employment Tax: RTE 2022-04
The End

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Questions and Comments