Tax and Personal Finance

Brandon Horton

Disclaimer: The information in this document is not legal advice. This document is for educational purposes only and provides a general overview of various tax- and finance-related topics. It is not a substitute for advice given by a tax professional. As tax and finance rules and regulations vary from state to state, always, consult a tax professional or legal counsel in the state in which you reside when seeking advice on tax-related matters.

Forward

In order for a person to reach their full potential, I believe they must have the willingness to try new things that are uncomfortable. The process can be scary, but every new thing we learn makes our world a little more manageable.

When I decided to become a Certified Public Accountant, I was in my mid twenties folding t-shirts at a local screen printing company. I asked the CPA in the office next door what I needed to do in order to "do what he does." He told me, "go to college and pass the 14 hour CPA exam." Impossible, right? I wasn't familiar with admissions, GPA, grad school, financial aid, state boards or much else. I was a young guy in recovery that wanted my life to have meaning. The next day I talked to someone in Admissions, connected with a guidance counselor, and enrolled in college. The rest is history.

When I was asked to write this manual, I jumped at the opportunity. It is my passion to share what I know about the complexity of business and help others become their best "self." My hope is that this manual will give you the basics of tax and personal finance in order to achieve all your goals. I wish you the best.

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Module 1: Employees, Independent Contractors and Payroll Basics

What is an independent contractor?

In the Peer Recovery Specialist (PRS) field, most specialists are paid as independent contractors. The Internal Revenue Service (IRS) defines an independent contractor on its website (irs.gov) in the following context:

People such as doctors, dentists, veterinarians, lawyers, accountants, contractors, subcontractors, public stenographers or auctioneers who are in an independent trade, business, or profession in which they offer their services to the general public are generally independent contractors. However, whether these people are independent or employees depends on the facts in each case. The general rule is that an individual is an independent contractor if the payer has the right to control or direct only the result of the work and not what will be done and how it will be done.[1]

What is important to notice in the definition of a contract employee is if the employer can control *only* the outcome of the services. For example, if an individual is hired as a Peer Recovery Specialist by a company and given clients to service, given the freedom to use their own methodology to help their clients, and set their own hours, they are in most instances an independent contractor.

If the above definition does not apply, they are an employee of a company.

Difference between an independent contractor and an employee

Independent contractors and employees are entirely different in terms of both payroll taxes and how the income is reported on the individual's tax return, which is known as Form 1040.

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[1] "Small Business/Self-Employed Topics." *Independent Contractor Defined*. Internal Revenue Service, 7 July 2016. Web.

Payroll Taxes

Upon hiring, an employer provides the new employee with IRS Form W-4[2] which once filled out by the employee, lets the employer know the correct amount of federal taxes to withhold from the employee's gross pay each pay period. This is an estimate of what the employee will owe the IRS on their individual tax return when they file their return.

In addition to federal taxes, the employer will deduct FICA tax[3] and state taxes (if applicable). FICA taxes consist of both Medicare and Social Security Tax. FICA taxes for an employee are treated differently than they are for an independent contractor.

Employees only pay **half** of the FICA tax, because employers are responsible for the other half. Independent contractors on the other hand, are asked to fill out a Form W-9[4], and will pay **all** of the FICA tax. The full FICA tax owed to the IRS by an independent contractor is known as Self Employment Tax[5], and one-half is deductible on their individual tax return. The full FICA tax is roughly 15.3% of business income. For a more detailed breakdown of FICA taxes visit irs.gov.[6]

Tax Reporting

As mentioned previously, employees and independent contractors report income on their tax returns in different ways. At the end of the year, employees will receive a Form W-2 and independent contractors will receive a Form 1099-MISC[7].

W-2

Anyone who has served as an employee will be familiar with the W-2. It is the form employers

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[2] "Form W-4." *Form W-4, Employee's Withholding Allowance Certificate*. Internal Revenue Service, 8 Sept. 2016. Web.
[3] "Topic 751." *Tax Topics - Topic 751 Social Security and Medicare Withholding Rates*. Internal Revenue Service, 14 Apr. 2017. Web.
[4] "Form W-9." *Form W-9, Request for Taxpayer Identification Number (TIN) and Certification*. Internal Revenue Service, 12 Sept. 2016. Web.
[5] "Self-Employment Tax." *Self-Employment Tax (Social Security and Medicare Taxes)*. Internal R, 7 Dec. 2016. Web.
[6] "Topic 751 - Social Security and Medicare Withholding Rates." *Tax Topics - Topic 751 Social Security and Medicare Withholding Rates*. Internal Revenue Service, 14 Apr. 2017. Web.
[7] "Form 1099-Misc." *Form 1099-MISC, Miscellaneous Income*. Internal Revenue Service, n.d. Web. 6 Sept. 2016.

distribute in January to detail gross pay received by the employee, taxes withheld, and deductions granted during the previous calendar year. The gross income will be reported on Line 7 on the individual tax return we file for the year of the W-2.

1099-MISC

A 1099-MISC is the form an independent contractor receives if they performed services valued at more than $600 for the year. Where this is reported on a tax return depends on whether it is trade or business income or other income. The IRS defines trade or business income in the following way:

The term trade or business generally includes any activity carried on for the production of income from selling goods or performing services.[8]

Generally speaking, if an independent contractor performs services for profit, they have business income.

If they receive income from an infrequent source, such as contributing to a project without any obligation for future services, that would most likely be considered other income.

Trade or business income is reported on a Schedule C attached to individual tax returns and is subject to Self Employment Tax. Also, independent contractors are able to deduct ordinary and necessary expenses incurred during the year in which services were performed.[9]

Other income is not subject to Self Employment Tax, but independent contractors are not able to deduct expenses that were ordinary and necessary incurred to receive that income.[10] Examples of "ordinary and necessary" expenses might be cleaning supplies purchased by a housekeeper or travel expenses incurred by salesperson in the course of a business trip.

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[8] ""Trade or Business" Defined." *"Trade or Business" Defined*. Internal Revenue Service, 7 Nov. 2016. Web.

[9] "Instructions for Schedule C." *2016 Instructions for Schedule C (2016)*. Internal Revenue Service, 2016. Web.

[10] "1040 (2016) Instructions." *1040 (2016)*. Internal Revenue Service, 2017. Web.

Module 2: Schedule C

What is a Schedule C?

The 2016 Instructions for Schedule C on irs.gov describe the Schedule C's use as the following:

*Use **Schedule C (Form 1040)** to report income or (loss) from a business you operated or a profession you practiced as a sole proprietor. An activity qualifies as a business if your primary purpose for engaging in the activity is for income or profit and you are involved in the activity with continuity and regularity. For example, a sporadic activity or a hobby does not qualify as a business. To report income from a non business activity, see the instructions for Form 1040, line 21.*[11]

As described by the IRS, the purpose of Schedule C as part of the individual tax return is to report income and expenses (activity) of a sole proprietor's trade or business. (See Module 1 for definitions of trade or business income and deductible expenses.)

Income

If a Peer Recovery Specialist (PRS) receives a 1099-MISC from a company for their services, it most likely will have the total payments received in box 7. (Box 7 represents income from non employee compensation.) The total amount noted in box 7 should be placed on line 1 of the Schedule C. If the PRS receives multiple 1099-MISC forms from multiple companies, they still generally file one Schedule C if all of the services were related to providing peer recovery services.

Expenses

Lines 8 through 27 relate to expenses incurred to perform services. These expenses include, but are not limited to, advertising, car and truck expenses, office expenses, rent (if services are performed in a rented space), supplies, travel, meals and entertainment, and other expenses not classified on the form. For more clarity on each category of expense see Schedule C

[11] "Instructions for Schedule C." *2016 Instructions for Schedule C (2016)*. Internal Revenue Service, 2016. Web.

instructions.[12]

As described in Module 1, independent contractors are able to deduct expenses that were ordinary and necessary to perform their services. There are, however, limitations to the expenses that can be deducted. For car and truck expenses there's an option to take either the standard mileage rate (2016 is 54 cents per mile) or the actual expense of operating the car, but not both. Note: Individuals must own or lease the vehicle if planning to take the standard mileage rate deduction. Consult the Schedule C instructions found at irs.gov for other limitations.

It is also possible to deduct equipment purchased under section 179 (known as a Section 179 deduction). IRS Publication 946 details this code section, but generally speaking, business property can be fully expensed in the year purchased up to a total of $500,000 per year.[13] However, one cannot generate losses on their Schedule C using this rule. For example, if you had income and expenses before applying section 179 totaling a loss of $1,000, you would not be able to increase your loss by deducting your equipment purchases. For more information on Schedule C, visit irs.gov or consult a tax professional.

Module 3: Estimated Tax Payments

What are estimated taxes and when do I pay them?

If an independent contractor receives income free of tax withholding, they must determine whether or not they owe estimated tax payments. This would include 1099 income previously discussed in Modules 1 and 2. Estimated payments are due to the IRS each quarter. Estimated payments are a way of ensuring the IRS gets the tax it is owed as income is earned. The payment dates are:

[12] "Instructions for Schedule C." *2016 Instructions for Schedule C (2016)*. Internal Revenue Service, 2016. Web.

[13] "Publication 946." *Publication 946 (2016), How To Depreciate Property*. Internal Revenue Service, 2016. Web.

Quarter 1	April 15th of the current year*
Quarter 2	June 15th of the current year
Quarter 3	September 15th of the current year
Quarter 4	January 15th of the following year

*This is when the tax return for the previous year must be filed.

Federal estimated tax payments are calculated on **Form 1040 ES**, which includes **vouchers** you can mail in with a check or money order.[14] The IRS also has an EFTPS option that allows you to pay your estimated taxes through a bank account draft, debit card, or credit card through their online website or by phone.[15]

Calculating Estimated Taxes

If $1,000 or more in federal tax is owed when the return for the previous year is filed, interest and penalties could be incurred. In order to avoid this tax the IRS allows individuals to pay 100% of the previous year's tax (if your adjusted gross income was $150,000 or less) or 90% of your current year's tax.[16]

Because current year income can be difficult to estimate, a good practice is to pay 100% of the previous year's tax. This is known as a safe harbor payment, which insures the taxpayer will not owe penalties and interest if they are underpaid. Most tax programs will calculate this number for you, but a rough calculation would be to use this formula:

Total Federal Tax on page 2 of your prior year return - Withholdings (line 64 of Form 1040) = Est. Tax Owed

Est. Tax Owed/4 = Quarterly Est. Tax Payments

[14] "Estimated Tax for Individuals." *2017 Form 1040-ES*. Internal Revenue Service, 2017. Web.
[15] "Small Business/Self-Employed Topics." *Estimated Taxes*. Internal Revenue Service, 12 Sept. 2016. Web.
[16] "Tax Withholding and Estimated Tax." *Publication 17 (2016), Your Federal Income Tax*. Internal Revenue Service, n.d. Web. 2017.

The following is an example of a calculation for an individual's federal estimated tax payments:

Total Prior Year Federal Tax	10,000
Withholdings on Prior Year W-2	-3,000
Total Estimated Payments Due	7,000
Dividend by 4 Quarters	/4
Quarterly Federal Est. Payments	**1,750**

Note: Depending on the state of residence, individuals may owe state income tax, which could require filing a state tax return and paying estimated state tax payments. Independent contractors should check with the state or consult a tax professional to determine whether or not they owe state estimated tax payments.

The IRS allows for a federal safe harbor payment, which allows the taxpayer to pay federal estimated payments equal to 100% - 110% of the the previous year's federal tax to prevent penalties and interest to incur from not paying enough in estimated taxes. The federal safe harbor payment for an individual making over $150,000 annually is 110% of the prior year's tax, and 100% of the prior year tax for any individual making under $150,000 annually. [17]

There are additional limitations when an individual's filing status is *married filing separately*.[18] For more details consult the Form 1040 ES instructions located at irs.gov.

Module 4: Personal Finance

Introduction

Once an individual begins to earn an income, they should begin to consider and establish their financial goals. The goals can be broad, such as living comfortably, or very specific (i.e. retiring at the age of 65). No matter what the financial goals are, there must be a plan to achieve them.

[17] "Tax Withholding and Estimated Tax." *Publication 17 (2016), Your Federal Income Tax*. Internal Revenue Service, n.d. Web. 2017.
[18] "Filing Status." *Publication 17 (2016), Your Federal Income Tax*. Internal Revenue Service, 2016. Web.

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Budgeting

A budget is a plan that details how much money an individual receives and spends and must be used when developing the plan to achieve personal financial goals. It can cover various periods, such as weeks, months, and even years.

To create a budget, first determine all net (or "take home") income. Net income represents gross pay minus taxes and deductions, such as health insurance or retirement investments. Next, list all expenses including rent, utilities, gas, groceries, insurance, entertainment, etc. Finally, subtract expenses from income. The result is a cash surplus or a cash deficit. A surplus indicates money left over after all expenses have been paid. A deficit means spending exceeds income and unnecessary expenses may need to be cut.

Below is an example of a simple budget:

Smith Family
Monthly Budget
2017

Income	4,000
Expenses	
Rent	(700)
Utilities	(300)
Auto insurance	(200)
Gym membership	(50)
Student loan payment	(250)
Surplus	**2,500**

Saving Money

Implementing a savings plan is paramount to having a sound financial future. Savings can be grouped into two categories: 1) short-term and 2) long-term.

Short-term Savings

A short-term savings plan is the easier of the two categories to plan and implement. One short-term savings goal for any household should be to establish an Emergency Fund. The Emergency Fund is used in the event of unexpected expenses. These expenses can include car repairs, medical bills, job loss, etc.

A solid short-term savings plan should start with an easily obtainable goal, followed by a more difficult goal as a person continues to save. For example, the first objective could be to save a specific amount of money in an Emergency Fund. After a person achieves setting up an Emergency Fund they may decide to save three to six months salary in case of a loss of employment or illness.

Long-term Savings

Long-term savings objectives might include buying a home and a secure retirement. When saving for the future, it is wise to meet with a financial advisor who can not only review and explain the many options available, but also recommend which investment vehicles will align with a long-term strategy. Commonly used investment vehicles include stocks, bonds, mutual funds, and certificates of deposit.

In addition, there are a variety of retirement plans available. Some include Individual Retirement Accounts (IRAs), Roth IRAs, and 401k plans.[19]

It's important to note that each of these retirement accounts is taxed quite differently. For example, an individual can deduct contributions to an IRA from their federal tax return up to a certain limit. When they withdraw money at retirement, they will owe tax. Roth IRAs are treated in the opposite way. One cannot deduct the contributions from a federal tax return when they're made, but the money will be tax-free at retirement.

401K plans are usually setup through an employer and the employer matches employee contributions up to a certain percentage.

When you put money into one of the three types of accounts described previously, it is important to know how the money will be invested. These accounts can hold stocks, bonds, and mutual

[19] *Types of Retirement Plans*. Internal Revenue Service, 19 Sept. 2016. Web.

funds, so consulting a financial advisor is important in planning how to allocate the contributions. The timing of investment and market conditions calls for careful planning by a knowledgeable professional.

For self-employed individuals, there are also other options such as a Simplified Employee Pension (SEP).[20] A SEP usually has higher limits on the amount a self-employed worker can contribute and deduct on their tax return.

This was just a brief overview of the most known retirement accounts. Most advisors have free consultations making them accessible to anyone who wants to save for retirement.

[20] *Simplified Employee Pension Plan (SEP)*. Internal Revenue Service, 28 Apr. 2017. Web.

When should I consult a professional?

Accountants, Attorneys, and Financial Advisors can be trusted allies when mapping out a financial plan. When it comes to activities like financial reporting, investing, creating a legal entity, tax planning, or complex tax questions, it is best to consult one or more of them. The costs tend to be much lower when working with a professional from the start, than they are when paying to fix problems caused by doing something incorrectly. For example, a mistake in tax planning, could result in owing taxes, penalties, interest, and professional fees in excess of the cost of consulting a professional to help in the planning stages.

Check with local financial institutions to inquire about free financial services they may offer. Some banks offer account holders free (or discounted) credit counseling and financial literacy training.

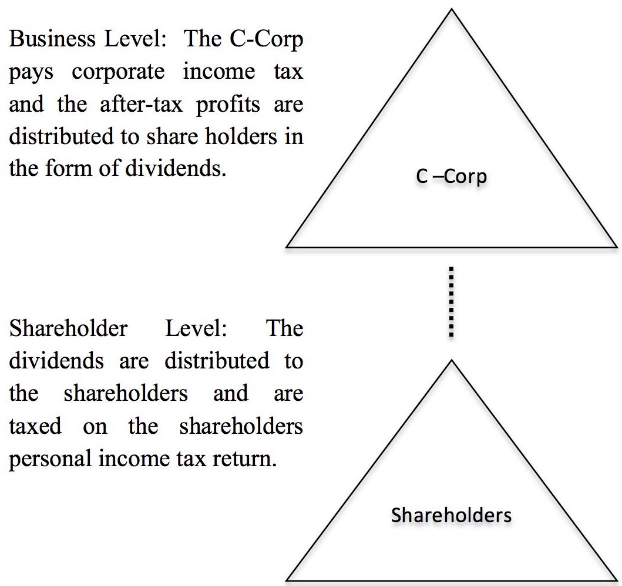
Module 5: Basics of Limited Liability Companies (LLC's)

What is a limited liability company?

History helps us understand the intention of a limited liability company (commonly referred to as an LLC). Before the LLC was created, corporations, partnerships, and sole proprietorships were the basic structure of most businesses. Stockholders own corporations; two or more partners own partnerships; and one individual owns a sole proprietorship.

Each of these entities had its own major advantages and disadvantages. General partnerships and sole proprietorships were flow through entities and income was taxed only once on the sole proprietor's or partner's individual tax return each year. For example, a person started a business selling skateboards and set up the business as a sole proprietorship. At the end of the year, the business paid no taxes, and the business owner paid the tax on the income. A general partnership is taxed in the same way. The partners all pay tax on their share of income and the general partnership is not taxed at the business level. The disadvantage was liability protection. If the sole proprietorship or general partnership was sued, the owner or partners were not protected from having to forfeit their personal assets to settle the suite. Personal assets could be their homes, automobiles, bank accounts, investments, etc.

A C-Corporation (C-Corp) was the opposite. The stockholders had liability protection, but the C-Corporation's income was taxed at the business level and again when the stockholders received the income in the form of a dividend. In practice it looks like this:



As you can see, when choosing which type of entity to create, taxation features and liability were critically important factors to consider. The need for both led businesses to create complex business structures in an attempt to achieve everything that the business desired.

Eventually, the limited liability company (LLC) was created. The LLC is easy to create, flexible in how it is taxed, offers liability protection and is taxed based on how the members set it up. For example, an individual business owner can create an LLC that is taxed as a sole proprietorship and has liability protection. Alternatively, a group of people can start a business in which they share income and expenses proportionately. They create an LLC that is taxed like a partnership, but includes liability protection for the members, whereas, a general partnership does not.

LLCs have many uses such as holding businesses, investments, and real estate. LLCs are ideal for consultants who work as independent contractors for several businesses. For example, the consultant starts Consulting Capital Services, LLC in their home state and runs all activities through the LLC. In theory, the consultant now has liability protection and is taxed only once on their individual tax return using Schedule C (See Module 2).

Is an LLC right for me?

There are several additional entities not discussed in this module, such as an S-Corporation, which provides liability protection and is only taxed at the shareholder level. The S-Corporation, however, has rules more complex for the purposes of this training necessitates, can be restrictive, and is not necessary for citing the advantages of an LLC.

When deciding on an entity formation to create a company, it is best to research state-specific requirements and limitations and consult an Attorney or CPA.

How do I form an LLC?

LLCs are formed at the state level. The business forms are usually filed with the Secretary of State. Many states allow non-residents to form LLCs. It is best to do independent research with the various Secretary of State websites and consult a professional to determine if a particular state is a good fit. Forming an LLC is usually as easy as filling out a form and paying a fee.

After creating the LLC, one can apply for an Employer Identification Number (EIN)[21] through irs.gov.[22] The EIN is used to file taxes and open bank accounts. The application process takes very little time, and the number is generated on the spot. Always consult a tax professional if unaware of the type of tax return that needs to be filed at the end of the year.

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[21] "Small Business/Self-Employed Topics." *Employer ID Numbers*. Internal Revenue Service, 10 Mar. 2017. Web.

[22] "Small Business/Self-Employed Topics." *How to Apply for an EIN*. Internal Revenue Service, 10 Mar. 2017. Web.

Module 6: Conclusion

Final Considerations

These training materials were created with a purpose of providing the user with an overview of basic tax and financial literacy. Although some topics were discussed in some depth, the reader should only use this booklet as a starting point. Once initial financial and tax plans have been drafted, readers should implement them only after consulting with authoritative literature and licensed professionals.

Remember, everyone starts at the same place. Remain patient and persistent when trying to achieve financial goals. Plan rewards for completing financial objectives. Ask for help when a mistake has been made.

Some may ask, “Where do I start?” - the answer depends on the present situation. If the objective is financial security and they’re not interested in working for themselves, they should probably start by creating a budget to see where they are financially. If the plan is to save money, start now! Start an Emergency Fund. Talk to a Financial Advisor about starting a retirement plan and learn from their expertise. Independent contractors who want to start a business, should speak with an Attorney or CPA to look into costs, tax implications, etc.

Whatever your professional and financial goals, we wish you the best of luck!

