



## Ways to Pay Income Taxes

With all the fun and excitement of the holidays upon us, the last thing any of us wants to think about is Tuesday, April 15, 2008, when income taxes are due. But as 2007 draws to a close, now is the time to lay out your game plan so you'll be prepared to meet your tax obligation to Uncle Sam. This issue of Dollars & Sense provides insights on certain aspects of paying income taxes to help you make wise decisions concerning your own tax obligations. ■



### What If I Can't Pay the Full Amount of Taxes by the April Deadline?

In a perfect world we're always able to pay all our bills, our kids' college tuition, our mortgage payment, our car payment—our this payment and our that payment. The list goes on. But what if April 15 rolls around and you find you can't pay the full amount of taxes you owe?

As explained by the Internal Revenue Service (IRS), if you cannot pay the full amount by the April deadline, you should still file your return on time and pay as much as you can to avoid penalties and interest. There are also alternative payment options to consider, including paying by credit card. However, given your efforts to climb out of debt and limit credit card use, you should approach paying your tax bill by credit card with extreme caution.

The IRS offers additional ideas for finding the means to pay your taxes, including a bank loan; liquidating savings accounts, savings bonds, stocks, and so on; borrowing against a 401(k) or life insurance; using equity in real estate or other assets. Remember that the IRS is more interested in collecting taxes than it is in what payment approach makes the most sense to you. So again, use wise judgment in determining the best payment alternative to meet your tax obligation.

- **Extending the Time to Pay:** Based on the circumstances, you could qualify for an extension of time to pay. The IRS is willing to allow extensions of time to pay in order to assist in tax debt repayment. A short-term extension of time to pay can be requested through the Online Payment Agreement application at [IRS.gov](http://IRS.gov) or by calling 1-800-829-1040. Taxpayers qualifying for an extension of time to pay of 30 to 120 days generally will pay less in penalties and interest than if the debt were repaid through an installment agreement.

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## Are You Self Employed? There's a Tax for That!

Self-employment tax (SE tax) is a social security and Medicare tax primarily for individuals who work for themselves. It is similar to the social security and Medicare taxes withheld from the pay of most wage earners. As explained by the IRS, you are self-employed if any of the following apply to you.

- You carry on a trade or business as a sole proprietor or an independent contractor.
- You are a member of a partnership that carries on a trade or business.
- You are otherwise in business for yourself.

### Trade or business.

A trade or business is generally an activity carried on for a livelihood or in good faith to make a profit. The facts and circumstances of each case determine whether or not an activity is a trade or business. You do not need to actually make a profit to be in a trade or business as long as you have a profit motive. You do

### Part-time business.

You do not have to carry on regular full-time business activities to be self-employed. Having a part-time business in addition to your regular job or business also may be self-employment. For example, let's say you're employed full time as an engineer at the local plant. You fix televisions and radios during the weekends. You have your own shop, equipment, and tools. You get your customers from advertising and word-of-mouth. You are self-employed as the owner of a part-time repair shop.

### Sole proprietor.

You are a sole proprietor if you own an unincorporated business by yourself, in most cases. However, if

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**“In this world nothing can be said to be certain, except death and taxes.”**

**—Benjamin Franklin**

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- **Installment Agreement:** The IRS may allow you to pay any remaining balance in monthly installments through an installment agreement. You can apply for an IRS installment agreement using the IRS Web-based Online Payment Agreement application on IRS.gov. Another alternative is to attach a Form 9465, Installment Agreement Request, to the front of your tax return. The IRS charges a \$105 fee for setting up an installment agreement. The fee is only \$52 if you pay via direct debit. If your income is below a certain level (see Form 13844), you may qualify for a \$43 fee. You will also be required to pay interest plus a late payment penalty on the unpaid taxes for each month or part of a month, after the due date that the tax is not paid. If you do not file your return by the due date—including extensions—you may have to pay a failure-to-file penalty.

### When do Penalties and Interest Apply?

Penalties and interest do not apply in years in which a taxpayer is entitled to a refund. About a third of those who file returns for past years discover they have a refund coming. Penalties and interest apply to years in which money is owed. The interest charged on late payments changes quarterly. During the last several years the interest rate has ranged from a high of 9 percent to a low of 4 percent.

The penalty for filing late is generally 5 percent per month, or part of a month, up to 25 percent of the amount of the tax shown due on the return. The penalty for paying late is 1/2 of 1 percent per month, up to 25 percent of the unpaid amount due.

The IRS recognizes that many people drop out of the system because of personal problems, including serious illness, a death in the family, or loss of financial records in a natural disaster. Depending on the situation, informing the IRS why returns have not been filed could result in a waiver of penalties. ■

you are the sole member of a domestic limited liability company (LLC), you are not a sole proprietor if you elect to treat the LLC as a corporation.

### Independent contractor.

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 typically independent contractors. However, whether these people are independent contractors 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. The earnings of a person who is working as an independent contractor are subject to SE tax.

By contrast, you are not an independent contractor if you perform services that can be controlled by an employer (what will be done and how it will be done). This applies even if you are given freedom of action. What matters is that the employer has the legal right to control the details of how the services are performed.

### Who Must Pay Self-Employment Tax?

You must pay SE tax and file Schedule SE (Form 1040) if either of the following applies.

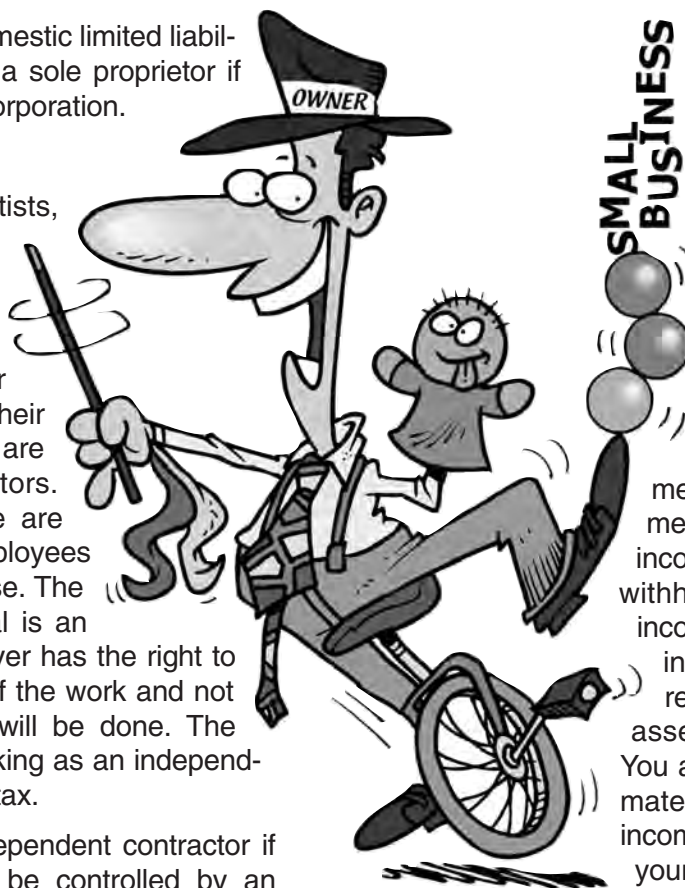
- Your net earnings from self-employment (excluding church employee income ) were \$400 or more.
- You had church employee income of \$108.28 or more.

Your net earnings from self-employment are based on your earnings subject to SE tax. Most earnings from self-employment are subject to SE tax. Some earnings from employment (certain earnings that are not subject to social security and Medicare taxes) are subject to SE tax.

If you have earnings subject to SE tax, use Schedule SE to figure your net earnings from self-employment. Before you figure your net earnings, you generally need to figure your total earnings subject to SE tax.

### Estimated Taxes

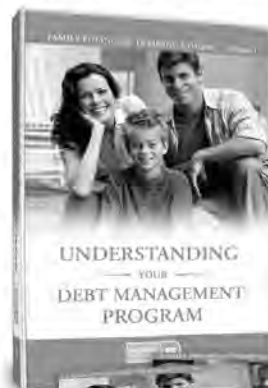
Federal income tax is a pay-as-you-go tax. You must pay the tax as you earn or receive income during the



year. You generally have to make estimated tax payments if you expect to owe tax, including SE tax, of \$1,000 or more when you file your return. There are two ways to pay as you go: withholding and estimated taxes. If you are a self-employed individual and do not have income tax withheld, you must make estimated tax payments. Estimated tax is the method used to pay tax on income that is not subject to withholding. This includes income from self-employment, interest, dividends, alimony, rent, gains from the sale of assets, prizes and awards. You also may have to pay estimated tax if the amount of income tax being withheld from your salary, pension, or other income is not enough. ■

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### Small Business Tax Tips

#### Five Ways to Pay Less Tax

If you own a small business and are worried about how much you'll have to pay in taxes this year, Accion International, which provides "micro" loans, financial services and business training to poor women and men who start their own businesses, suggests five simple ways to decrease what you owe:

- 1. File your income tax return on time or obtain a filing extension.** If you don't, you risk interest and penalties for late filing. You also lose the opportunity to make certain tax choices required on a return filed on time.
- 2. Use retirement plans not only to save for your retirement needs, but also to reduce current taxes.** If you have not yet set up a retirement plan, consider a Keogh, SEP, or SIMPLE plan to put more away on a tax-deductible basis than you can under an IRA. Contact a financial advisor to set up a retirement plan.
- 3. Keep good books and records for your business.** Keep these records separate from records of your personal expenses. Keep good records to track both small and large expenses; small expenses can add up to significant expenses. Keep these business records as long as necessary. Generally, this is at least three years after the date you filed your income tax return. In some cases, however, it's a good idea to keep records even longer.
- 4. Keep records to substantiate your travel and entertainment expenses for your business.** While you don't have to keep receipts for expenses (other than lodging) of \$75 or less, you must still note in a log or diary the business purpose for the expense, the date it was incurred, and the amount you spent.
- 5. Make sure to run a part-time business in a business-like manner, in case it incurs a loss.** By keeping records of your part-time business, you'll be able to prove a profit motive and deduct the loss of the business from your taxes. Keep

separate books, records, and business bank accounts and change business operations with an eye toward making a profit. ■

### Get Educated on Tax Rules and Deductions!

Whether you are selling items you created in your hobby, doing a little freelance on the side, setting up an internet business, or starting out in your own storefront with a handful of employees, it is definitely in your best interest to become educated in the taxes you are responsible for paying—and hey, you might even find a few extra tax deduction ideas along the way!

- Don't forget the mileage on your vehicle. If you are using your personal vehicle to deliver items, purchase supplies, or take a client to lunch write the mileage down. The 48.5 cents/mile (2007) allowance rate might not seem like much, but it adds up over time.
- Need the phone or internet for your business, but you only have a personal line? A percentage of the monthly bills may be deductible.
- Education expenses related to your business are 100% deductible.

Tax classes for small business can be found in most communities through continuing or adult education courses, or through your local chamber of commerce. The website [www.irs.gov](http://www.irs.gov) also has some good articles. And guess what? The cost of a tax class is even deductible! ■

#### Family Financial Education Foundation

ACCESS EDUCATION SYSTEMS

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724 Front Street, Suite 340

Evanston, WY 82930

(307) 789-2010, toll-free (888) 292-4333

[www.accesseducation.org](http://www.accesseducation.org)

