



# Self-Employment Tax

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# Rural Tax Education

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RuralTax.org



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- Informational Material on Ag, Timber, and Rural Tax topics include but not limited to:
  - Disaster/Weather Losses
  - 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

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- 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

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- 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

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1. Net Farm Income = \$100,000 (below \$147,000 limit)
  - $\$100,000 \times 92.35\% = 92,350$
  - $92,350 \times 15.3\% = \mathbf{\$14,130}$  total SE Tax
2. Net Farm Income = \$150,000 (above \$147,000 limit)
  - $\$147,000 \times 92.35\% = 135,755$
  - $\$135,755 \times 12.4\% = \mathbf{\$16,834}$  Social Security portion
  - $\$150,000 \times 92.35\% = \$138,525$
  - $\$138,525 \times 2.9\% = \mathbf{\$4,017}$  Medicare portion
  - $\$16,834 + 4,417 = \mathbf{\$21,251}$

# Farm Employees

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- 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

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- 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

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- **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

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- 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

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## 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

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## 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

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- 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

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## 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

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- 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

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## 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 =  $15.3\% \times 4,000 = \$612$
- 2 quarters of coverage are earned (\$4,000 of reportable earnings  $\div$  \$1,510) for benefits



# Examples: Farm Optional

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**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 ( $\$5,000 \div \$1,510$ )
- If elect to use the optional method, report \$6,040 as earnings from self-employment (4 qtrs. = \$6,040)
- SE Tax =  $15.3\% \times 6,040 = \$924$

# Farm Optional Method

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- 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

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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

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Age	Income	Withholding
Under Full Retirement Age	\$19,560	For every \$2 over the limit, \$1 is withheld from Social Security benefit
In the calendar year full retirement age is attained	\$51,960	For every \$3 over the limit, \$1 is withheld from Social Security benefit

# References

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- IRS Publication 225, Farmer's Tax Guide
- Social Security Administration <https://www.ssa.gov>
- [www.RuralTax.Org](http://www.RuralTax.Org) Select Tax Tips
  1. Self-Employment Tax: RTE/2022-07
  2. The Optional Method of Paying Self-Employment Tax: RTE 2022-04

# The End

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## Questions and Comments