



ESTABLISHING YOUR FREELANCE BUSINESS 101

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LESSON #9

The Government and Other Authorities

As your work increases, you'll need to consider the legalities of owning and running a freelance business. I am not an attorney, so I'm not offering legal advice. But I offer a few things to think about.

Business License

Do you need a business license? All states in the United States have a general rule that anyone conducting a business must have a license, renewed annually for as long as they're in business (for a fairly nominal fee). But different states have different requirements, so you should do an internet search for your state's official website to determine the requirements for yours. Many states require a business license if you're selling a product but not if you're providing a service.

Cities and counties also have business license requirements, so you should check that as well.

Some banks will not allow you to open a business checking or savings account without a business license. Some banks will let you do so in your own name, but not under a DBA.

Business Name

You do not need a business name (DBA), although you may choose one if you wish. Your business name may include the word *company*, but not *Corp.*, *Corporation*, or *Inc.* unless you have set it up as a corporation.

Before you settle on a business name, do an internet search for the name you want to see if anyone else is using it. If you find another business with the name you want, consider something similar, or think about whether there's likely to be any confusion between your company and theirs. You may also want to check <http://www.uspto.gov/trademarks/process/search> to determine whether someone else has trademarked that name.

Once you've decided on a business name, file a Fictitious Business Name Statement with the county where your business will be located. An internet search of "Fictitious Business Name" and the name of your county will pull up services that handle the recording and publication for a small fee (typically less than \$100).

If you get a check payable to your business name, you'll have trouble cashing it unless you show your bank a recorded FBN statement. With it, you can set up bank accounts and obtain credit cards in your business name.

You don't need to register your business name as a trademark. Trademark application fees are more than \$300, and the process is rather complex.

Once you decide on a business name, buy the domain name ASAP. (I use Namecheap for all my domain names. It's super easy to use. But there are other equally good ones out there.)

[Note from Christi: I've used [GoDaddy](#) in the past and currently use [Bluehost](#) to buy my domains.]

(Note: If you use a business name, whenever you make a payment for something, whether by check or by PayPal, remember to also use your personal name. I can't tell you how many payments The Christian PEN and CEC receive that give only a business name, and we have no idea who the payment is from.)

Incorporating

Do you need to incorporate? Highly unlikely. Businesses incorporate to shield the owner's personal assets from business liabilities, but incorporation provides little benefit to an author or editor. And forming and maintaining a corporation costs hundreds of dollars each year.

For some small businesses, incorporating can have certain advantages. For example, the profits of an incorporated business would be taxed at a corporate rate rather than being added to your personal income. Segregating your business income from other income sources could place you in a lower overall tax bracket.

Incorporating can also help shelter your personal assets from litigation. However, there isn't much of a risk of being sued in our profession.

If you do incorporate your business, there are reporting and filing requirements that can add a lot of complexity to your life (and nonbillable hours to your day).

No formula exists, to my knowledge, to determine whether and to what degree you might obtain tax benefits from incorporating. It depends on your specific situation in any given year. So if you're considering this option, be sure to consult a knowledgeable tax accountant or tax attorney, and carefully consider all the benefits and burdens involved.

Sales and Use Permit and Taxes

Traditionally, sales tax applied only for tangible products sold, not for services provided. However, in the past few years, the number of small service businesses has grown at an incredible rate. So some states have made services liable for sales tax as well. In some states, lawmakers have taken a piecemeal approach, declaring some types of services as taxable while others are not.

To determine whether your editing services are subject to sales tax in your state, go to www.bizfilings.com/toolkit/sbg/tax-info/sales-taxes/sales-use-taxes, and click on your state.

If you sell a product along with your editing services (for example, flyers or books about writing or books you've written), you should have a sales permit and charge sales tax on those products, which you would forward to the government of your state—unless you live in a state that does not charge sales tax and you only plan on selling within your own state.

You will report your sales on sales-tax returns filed quarterly or annually depending on the state. There are substantial penalties for failing to file returns (even if you have no sales) and failing to account accurately for sales.

The amount of sales tax depends on the location of the *buyer*. Sales tax is based on the selling price of the item, not on your net profit from the sale. Some states charge sales tax on digital downloads, so sales tax may apply if you are delivering your e-book or other content directly to buyers via downloads.

If you sell your book for an even dollar amount, you can write “sales tax included” on the receipt. Then you need to figure out what portion of the dollar amount is sales tax.

For some excellent detailed information on this topic, check out <http://biztaxlaw.about.com/od/typesofbusinesstaxes/ht/statesalestax.htm>.

I recently heard about [Avalara](#), which offers “sales tax automation” products, including AvaTax, which “makes sales tax calculations as the transaction takes place via a secure, encrypted internet connection without disrupting existing workflow.” I don't see a price for this service on the website, which makes me think it's probably pricey, but considering how complex the issues are surrounding sales tax, it might be worth checking into if you're serious about making money by selling things through your website.

If you do a Google search with “online sales tax,” you'll find links to several helpful-looking articles. This one seems to have valuable information:

<http://www.nolo.com/legal-encyclopedia/50-state-guide-internet-sales-tax-laws.html>.

If you have clients who are planning to self-publish, you may want to do them a favor and let them know that publishers are required to collect and pay sales tax. If they are self-publishing, that makes them “publishers.” They would be wise to look up the laws in their state.

Incidentally, people who pay for a service (such as editing, proofreading, ghostwriting) are called “clients.” People who pay for a product (such as a book) are called “customers.”

Neighborhood Associations

Some neighborhood associations have rules in their CC&Rs prohibiting residents from conducting businesses from their homes. These rules are intended to keep the neighborhood from becoming commercial (with neon signs and a need for additional customer parking) and to avoid having to comply with government regulations for businesses (such as providing handicap access). Since your business will be conducted by email/mail (and probably won't load up the mailbox much more than someone who isn't in business), your neighbors won't be affected.

The IRS

If you don't have a tax preparer who has a solid understanding of small businesses, I strongly advise you to find one. You may want to log on to www.irs.gov, download the appropriate forms and instructions, and study them for yourself. But you should definitely check with a tax professional to verify how these laws apply to you personally, for your area, and in your situation.

Here are a few things you need to consider as a freelancer.

Hobby or Business?

Even if you don't apply for a business license or sales permit or DBA from your local or state authorities, the Internal Revenue Service wants to know if you're making money. That's why it's important to carefully keep track of your income and expenses.

According to the IRS, if the “primary purpose” for your editing is “income or profit” and you are involved in that activity “with continuity and regularity,” that's a business. A “sporadic activity or a hobby” does not qualify as a business.

Schedule C

If your editing qualifies as a business, you'll need to file a Schedule C (“Profit or Loss from Business”) with your Form 1040 U.S. Individual Income Tax Return. Schedule C is an easy form to fill out. In Part I, you enter how much you earned for the calendar year in question. In Part II, you list your expenses, divided into various categories. If your income is more than your expenses, you made a profit. If your expenses are greater than your income, you had a loss for that year.

If you have a net loss on your business, that amount is deducted from your taxable income (if you have another job or file jointly with your spouse). If you have a net profit, that profit is taxable income, transferred to your Form 1040.

Your business will be a “sole proprietorship” (may be owned by you alone or by you and your spouse). If you are combining efforts to produce and share income with one or more other people, you have a “general partnership.”

EXPENSES

Here are some of the expense categories on Schedule C:

- Advertising
- Car and Truck Expenses
- Commissions and Fees
- Legal and Professional Services
- Office Expenses
- Repairs and Maintenance
- Supplies
- Travel
- Meals and Entertainment
- Wages

You don't have to be too concerned with what expenses go in which category. The main concern is that you don't double-dip (put the same expense in more than one category) and that all expenses are legitimate costs of doing business.

Some professional tax consultants recommend that you open a separate business bank account. But if you're careful about saving receipts and count only legitimate expenses, there's not a real problem with mixing personal and business income and expenses.

BUSINESS USE OF YOUR HOME

You can deduct the expenses that apply to a portion of your home *only if* that part is directly and exclusively used on a regular basis

- as your principal place of business;
- as a place used by your clients to meet or deal with you in the normal course of your business; or
- in connection with your business if it is a separate structure that is not attached to your home.

The key words here are *directly*, *exclusively*, and *regular basis*. That means your home office must be *directly* connected to your business. You must use that part of your home *exclusively* for business (and nothing but business). And you must use it on a continuing, *regular basis*.

Health Insurance

If you are self-employed and had a net profit for the year, you may deduct the cost of health insurance for yourself, your spouse, and your dependents on your Form 1040. The insurance plan must be established under your business.

If you are also eligible for insurance through your employer or your spouse's employer, you are not eligible for this deduction.

Schedule SE

If you have a net profit on your business, be sure to also file a Schedule SE (“Self-Employment Tax” form). Technically, you have to use this form only if your net profit is \$400 or more; however, it wouldn’t be a bad idea to do this even if your profit is lower.

Form 1099-MISC

You are to report payments of \$600 or more to independent contractors on Form 1099-MISC. This includes fees and commissions for services performed as a nonemployee.

Examples include:

1. Professional service fees
2. Fees paid by one professional to another
3. Exchanges of services between individuals in the course of their businesses

Estimated Quarterly

If you make a fair amount of income from your business, the IRS will want you to make estimated payments during the year. What’s a “fair amount”? Well, that depends on your income situation. As a rule of thumb, if you make enough income from your business to exceed \$1,000 in a calendar year, you should make estimated payments. But check with www.irs.gov or your tax preparer if you think this may apply to you.

If it does apply, quarterly estimated payments will be due January 15, April 15, June 15, and September 15. These payments need to be accompanied by Form 1040-ES, which you can download off the IRS site. (After you’ve made quarterly payments one year, preprinted forms will be mailed to you in subsequent years.)

You may also need to make quarterly estimated payments on your state taxes, using your state’s form.

The Freelancers Union has many helpful resources if you are a member:

<https://blog.freelancersunion.org/2015/02/20/ultimate-tax-guide-freelancers/>. Or check out these free tips: <https://www.daveramsey.com/blog/file-taxes-for-freelance-work>.

IRS Help

Tax laws change every year. For updates and more information, visit the [IRS website](http://www.irs.gov) or call them toll-free at 800-829-1040. The IRS has comprehensive guidelines on keeping records as well as all the forms and instructions you will need. Most forms can be downloaded and printed off the website.

This is just a brief overview of tax tips. Keep in mind, I am not a tax expert and am not giving legal advice. Be sure you check with a professional tax preparer for more details on this subject.

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LESSON #9 ASSIGNMENTS

To receive a Certificate of Completion, you need to complete at least two assignments from each lesson.

Assignment #1. Business License

Research your state and local laws regarding business licenses. Share with the class what you find.

Assignment #2. Sales and Use Permit

If you sell any products along with your editing services, research your state and local laws regarding sales permits. Share with the class what you learn.

Assignment #3. Neighborhood Associations

If you live in an area that is controlled by a neighborhood association, look up the rules regarding home businesses in your CC&Rs. If you find a rule about this, share what you discover with the class. (And let us know what you will do about it.)

Assignment #4. Tax Preparers

If you've had any experiences (good or bad) with a professional tax preparer, especially relating to self-employment/small businesses, share your experience with the class.

Assignment #5. Hobby or Business

Based on the criteria above, do you believe the IRS would consider your editing a hobby or a business? Explain your answer to the class.

Assignment #6. Incorporating

If you've decided to incorporate your editing business (or have seriously considered doing so), share your reasoning with the class.