



How to Waste Money

The Motley Fool

[By Tim Beyers]

So, it's time once again for me to file my taxes. Confused? Don't be. I'm a late filer, which means I'm taking advantage of the Oct. 15 deadline for 2005 federal and state returns.

Not that I planned this or anything. The same arrogance and disorganization that plunged my family and me [back into debt](#) also set back my tax filings. Over the past month, my nights have been spent shuffling papers that have gone unaddressed for months.

It's nice to be done with the process. But I'm also annoyed; I know I've missed deductions because of my laziness.

Money left on the table

Turns out I'm not the only one. According to a March study from *The Wall Street Journal Online* and **Harris Interactive**, only 61% of Americans surveyed say they are consciously taking steps to reduce their tax bills.

And only 19% of those said they plan to deduct certain purchases as work expenses. Frankly, that's insane. Why? Self-employment tax. SE tax is, in effect, a double-tax for Social Security and Medicare. While W-2 workers share the cost of Social Security and Medicare with employers, contractors like me have to pay the whole bill.

There's a small deduction for one-half of the SE tax allowed when computing the final tally, but that money comes off the top, where it has the least impact. Let's briefly run through the math, assuming that you are married, filing jointly, and made \$90,000 in business income during 2005.

First, you and your employer are required to pay 6.2% in Social Security tax on the first \$90,000 of income. Since you're self-employed, that amounts to a 12.4% tax bite. Next, Medicare tax applies to all income and

costs you and your employer 1.45% each. That comes to 2.9%. So, overall, you're going to pay 15.3% in SE tax.

Seem straightforward? Well, it isn't. Not all of your business income counts — only 92.35% of it. That leaves you with \$83,115 in applicable earnings, which results in \$12,717 in SE tax. One-half of that, or \$6,359, is going to be deductible.

But again, that's going to come off the top, just like itemized deductions, child credits, and IRA contributions. Assuming you found \$40,000 worth of those — a reasonable figure, especially if you own a house — then your \$50,000 in adjusted income would result in \$6,770 in tax owed. (That's \$1,460 for 10% of the first \$14,600 plus \$5,310 for 15% of the remaining \$35,400.)

Now, add to that — *gulp* — \$12,717. Your total 2005 federal tax bill would have been \$19,487, or 22% of your net earnings. See why I'm kicking myself for being lazy?

Three ways to cut your tax bill

If you're self-employed, you need to be thinking about taxes all year long. Here are three ways to keep Uncle Sam's grubby hands off your moola while you're running your business:

Ruthlessly track work expenses. Anything that helps you run your business is a deduction. For me, as a financial writer, that includes all of the research I buy, every newspaper and related magazine I read, and all of the investing books I buy. No expense is too small. Last year, for example, I included a \$1.06 purchase of a newspaper.

(I referenced a pair of articles within for a speech given the same day.)

Invest aggressively. Self-Employed, or SEP, IRAs and Solo 401(k) plans can be wonderful instruments for generating tax-deferred wealth while, at the same, cutting your present tax bill. With an SEP, you'll be able to sock away 25% of your adjusted business earnings. With a Solo 401(k), you get the same \$15,000 contribution limit a W-2 employee does *plus* a contribution based on up to 25% of net business income. And either plan will let you invest in top funds such as the **Vanguard 500 Index**, which boasts holdings in blue chips such as **Citigroup** (NYSE:C), **American International Group** (NYSE:AIG), and **Microsoft** (NASDAQ:MSFT). Speculative stocks, too, are fair game. Can you imagine holding companies such as **Akamai** (NASDAQ:AKAM), **Cray** (NASDAQ:CRAY), and **Gymboree** (NASDAQ:GYMB) in your retirement account? It's possible.

Design a deductible health plan. Though it's probably best to see an accountant to understand all of the rules required to earn the deduction, you may be able to write off much or all of your health-care expenses as an employer-sponsored benefit plan. In our case, both my wife and I had to be employed by the business and file extra tax reports with state of Colorado. Still, the extra hassle is worth thousands to us annually.

Follow the money

I hate giving away money. During 2005, I did it far too often thanks to an oversupply of laziness. Well, no longer. I'm reducing debt and am once again getting smart about tax planning. Promise me you'll do the same,



especially if you're one of the estimated 19.5 million self-employed Americans. Thousands of dollars could be at stake if you don't.

Have other money tips? [Tell me](#). I'm writing new articles on personal-finance and investing basics every week as part of our new personal-finance service, [Motley Fool GreenLight](#). It's tailor-made for Fools like

you who aim to take control of their financial destiny. [Click here](#) to learn more.

Fool contributor [Tim Beyers](#) has been self-employed since 2002 and still loves it, even with the SE tax. Tim owns shares of Akamai, which is also a Motley Fool Rule Breakers pick. Get a peek at everything he's invested in by checking his Fool [profile](#). Microsoft is

an Inside Value selection. The Motley Fool's [disclosure policy](#) is never lazy.

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