

FEMALE FINANCE

HOME SWEET HOME BUSINESS

A Self-Employment Survival Guide

By Elizabeth Lewin

Wouldn't it be so much easier to juggle work and family if you could do both from one place? That's the reasoning that leads many women to start their own businesses, or to become self-employed consultants, working out of their own homes. Many thrive; others take a dive. There are several important things to consider before you decide to go it alone, not the least of which is the fact that the way you handle your taxes, your health insurance and your retirement savings will change.

You will be in good company, if you do, however: More than a third of women-owned businesses, or 3.5 million of them, are family affairs, operated out of spare bedrooms or basements. Most of these businesses are small, employing fewer than 10 people.

Val started a booking agency for Texas

musicians 10 years ago. "All I needed was an extra phone line for the fax and computer. I was able to save on rent and was eligible for a partial tax write-off of the utilities and maintenance for that part of the house." But she admits it was difficult to set boundaries between work and family obligations, especially when her son came home

from school. "You have to be self-disciplined to work from home," she says. "My contact with the outside world was by telephone. I would try to meet friends for lunch just to see and talk with

a live human being."

As Val discovered, there are many advantages—and disadvantages—to setting up a business at home.

The Pros: You get tax benefits for your home office (consult your accountant to make sure you conform to stringent IRS



rules or check IRS Publication 587); the overhead is less than if you were renting space elsewhere; and there are no commuting costs. You don't have to spend as much on clothes, and you might not need extended day care for your school-age children. You can also write off work-related expenses. One woman used to deduct snow removal as a business expense—how else would her clients get to her?

The Cons: There's no certain paycheck. This can be nerve-racking. And it's often difficult to keep your work and home life separate. Depending on the business you are in, there are also a number of potential liabilities and risks to consider. If your home business involves child care, for instance, you will need strong liability coverage. Even if you are a consultant who merely works the phone and keeps files at home, you should consider purchasing home-office insurance. The premiums will be tax-deductible as a business expense.

Start by checking with your insurance agent about what sorts of things your home insurance policy covers. One woman kept her files in the basement, and when the water heater exploded, she lost a lot of crucial information. Her loss was not covered. Definitely put a back-up system in place to protect your records in case of fire or disaster. Some companies (The Hartford, for one) offer extensions to home insurance policies to protect home business owners. Visit <http://aarp.thehartford.com/homebusiness/liabilities.html> for more information.

Growing Pains

Often women will start a business out of their home and move to an office setting when their business grows. It didn't take Val long to realize that she couldn't keep up with the business end of the business by herself. "I deal with so much paper work," she says. "Contracts, promotional material, CD's, touring schedules, billings, etc. It became overwhelming, and the trips to the

post office took hours." She finally moved to an office in town and hired Gigi, who handles the paperwork plus keeps the financial records in order. She has added two part-timers since then and now has five phone lines and several linked computers. The part-timers help Gigi get all the materials out and keep the business organized.

"After 10 years in this business, I would do anything to take two straight weeks off at any one time," Val says. "No ringing phones, no faxes, no e-mails. But that's not possible. My son finishes high school next year, so I'm thinking of moving the office back home. The money saved in rent would go to the ever-increasing costs of providing medical insurance for my family and one full-time employee." She suggests, with tongue only partly in cheek, that small business owners make sure they have a spouse with a corporate job and a terrific health plan to cover the family's medical insurance.

Change of Plans: What You Need to Know About Taxes, Health Insurance and Retirement Savings

How you pay for health insurance isn't the only thing that is likely to change once you become self-employed. Where previously you may have had a 401(k) plan, with employer matching contributions, it will now be up to you to open a tax-deductible retirement account for yourself, as well as for any employees you might have.

Since, at least initially, you may not have a steady stream of income, and you will no doubt have startup expenses to report, your tax situation will be more complicated. Bear in mind that your Social Security benefits, which are based on your 35 highest earning years, may be impacted, as well. You must have a minimum of 10 years of recorded earnings, in order to qualify for Social Security payments when you reach retirement age.

Here's a quick rundown of requirements and options in each area: →

Health Insurance: Forty percent of small business owners go without coverage. Health insurance is costly, but worth it, and there are some affordable options to consider: If you're not married or your spouse doesn't have coverage, and you're leaving a job, voluntarily or involuntarily (unless as a result of misconduct) where you currently have health coverage, you are eligible to continue that policy, paying the group rate, for 18 months under COBRA (the Consolidated Omnibus Budget Reconciliation Act of 1985). Take it.

When the 18 months is up, you have the option of continuing at a single-policy-holder rate. Shop around before accepting it. You may be able to find a group rate through an association you belong to or even your local Chamber of Commerce, if you are a member. If you

employ between two and 50 people (a family-run business might benefit from this option), you might also qualify for a group health insurance policy. Shop the Internet and local brokers for the best deal.

While premiums are higher for the self-employed in both individual and group policies, the good news is that premium costs are tax-deductible up to 100 percent, as long as you earned a profit and the cost of the premiums is not more than the amount you earned. If you can't afford a single policy and don't qualify for a group policy, opt for catastrophic coverage so that you have some protection should an unfortunate accident or illness befall you. Only buy what you need. Skip dental and vision if you can't afford them.

Link a catastrophic policy to a Health Savings Account (HSA), and you'll have a built-in tax deduction. Visit www.msainfo.net for more information. Keep alert for changes

In business with your husband? You should each report your share of the profits as net earnings on separate self-employment returns, if you file a joint income tax return.

in the tax code, too, which may benefit the self-employed and small business owners; during the campaign, President Bush promised tax credits for those investing in HSA's and proposed a plan that would allow small businesses to band together to purchase group policies. Don't forget disability insurance; if your business income depends solely on you, it might prove just as important as health insurance—if not more so.

Retirement Savings: Besides health coverage, as you grow, you'll want to offer your employees and yourself a retirement savings plan. Retirement plans for the self-employed and small business owners

include Keoghs, SEP-IRAs, simple IRAs, and self-employed 401(k) plans. Discuss the tax advantages of each of these options with your accountant or tax adviser before

deciding which one is best for you. Here's a snapshot of each.

A *Keogh plan* is qualified retirement plan for sole proprietors or partners. It allows an annual contribution of up to 25 percent of earned income to a maximum of \$40,000, tax deferred. Certain types of Keoghs require the self-employed to contribute a fixed percentage of income every year. Annual filings are required by the IRS.

The *SEP-IRA, or Simplified Employee Pension IRA*, is an employer plan and only the employer can contribute, with a limit of 25 percent of earned income for each employee and the owner, up to a maximum of \$40,000. There is no limit to the number of employees eligible. These plans are easy to set up and maintain, since there are no annual filings to make. You don't have to make a contribution every year.

Simple IRAs are available to employers with one to 100 employees. The maximum

SELF-HELP FOR THE SELF-EMPLOYED

Make your first stop www.sba.gov for the basics on starting your own business.

Go to

www.dinkytown.net/java/TaxSelfEmployment.html for a financial calculator that will help you estimate your self-employment tax.

Visit www.firstgov.com/Business/Self_Employed.shtml for more information on taxes, retirement plans, Social Security and Medicare payments for the self-employed.



contribution per employee is \$8,000 annually. As the name implies, these plans are easy to set up and administer.

Self-employed or solo 401(k) plans are a new retirement vehicle for the self-employed. Multiple owners and spouses (no employees) are eligible to contribute. You can contribute up to \$12,000 per year. You don't have to contribute each year and can move money into the plan from other IRAs.

Contributions to all of these plans are tax-deductible; some permit loan withdrawals, some do not. For self-employed workers, the contribution is based on the net profit from the business (not gross income).

An individual IRA is also an option for the self-employed. If you qualify for a tax-deductible IRA, you'll have to decide which is the better vehicle for you: a plan that offers you a tax deduction now (a traditional IRA) or one that offers a tax-free withdrawal later rather than a deduction today (a Roth IRA). There is no easy answer, of course: you have to consider such factors as your age, your current income, and your expected tax brackets during your working and retirement years. As a rule of thumb, you'll do better with a Roth IRA if you expect to be paying a substantially higher tax rate after retirement than you are currently paying.

Taxes: You will now be responsible for reporting your income, paying a portion of your estimated income tax as well as your Social Security and Medicare payments, to

the IRS quarterly (unless your total tax due is less than \$1000). If you are a sole proprietor (as most self-employed businesswomen are), you will report your income on Schedule C—Profit or Loss from Business. In addition, you'll need to complete Form 1040 (U.S. Individual Income Tax Return) and Schedule SE (Self-Employment Tax) for any year in which you have net earnings of \$400 or more. You subtract expenses from gross income and pay tax on the net profit. The Social Security tax rate for 2004 is 15.3 percent on self-employment income up to \$87,900. If your net earnings exceed \$87,900, you continue to pay only the Medicare portion of the Social Security tax, which is 2.9 percent, on the rest of your earnings. Even if you don't owe any income tax, you must complete Form 1040 and Schedule SE to pay self-employment Social Security tax.

In business with your husband? You should each report your share of the business profits as net earnings on separate self-employment returns (Schedule SE), even if you file a joint income tax return.

One final important note: The IRS will not allow you to run a business that continually loses money. If you don't show a profit in at least three of every five consecutive years, it will consider your business a hobby. □

Elizabeth Lewin is a financial planner and contributing editor to MAKING BREAD. She is the author of "Family Finance" and many other books on money management.

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