

A taxpayer is allowed a deduction for the employer's portion of the self-employment tax (currently one-half) as a deduction from gross income.

EXAMPLE 3.24

In 2021, Pierre Painter, a self-employed artist, had \$45,000 in self-employment income. His deductible business expenses amounted to \$15,000. Pierre's self-employment tax is computed as follows:

Gross income from self-employment	\$45,000
Less: Business expense deductions	<u>15,000</u>
Net self-employment income	\$30,000
Less: Deemed deduction ($\$30,000 \times 7.65\%$)	<u>2,295</u>
Net earnings from self-employment	\$27,705
Self-employment tax ($\$27,705 \times 15.3\%$)	<u>\$ 4,239</u>

On Form 1040, Schedule SE, Pierre would simply multiply his net self-employment income of \$30,000 by .9235.

The cap on wages and self-employment income that is taken into account in calculating the portion of the FICA tax applicable to old-age, survivors, and disability insurance (OASDI) is \$142,800 for 2021. This also applies to wages, self-employment income, and income derived under the Railroad Retirement Act. There is no longer a cap on wages and self-employment income that is taken into account in calculating the Medicare hospital insurance (HI) portion of the self-employment tax.

EXAMPLE 3.25

Katie Adams has \$150,000 in self-employment income for the year. Her net earnings from self-employment is \$142,800 ($\$150,000 \times .9235$). She will be subject to an OASDI tax of \$17,707 ($\$142,800 \times 12.4\%$) and an HI tax of \$4,017 ($\$138,525 \times 2.9\%$). Thus, her total self-employment tax is \$21,724.

Thus, self-employment and Social Security (FICA) tax rate parity is achieved between self-employed persons and employees. Both employees and their employers are liable for Social Security tax and the employer must contribute 6.2 cents per dollar earned by the employee up to the cap limitation (\$142,800 for 2021) for OASDI and another 1.45 cents per dollar without a cap for HI.

The net earnings from self-employment subject to the OASDI portion of the self-employment tax are limited to the self-employment base (\$142,800 for OASDI and unlimited for HI in 2021) less any wages from which Social Security tax was withheld during the year. Thus, the tax is applied to the lesser of (1) the self-employment base (\$142,800) minus income subject to Social Security taxes or (2) the net earnings from self-employment.

EXAMPLE 3.26

In 2021, Margaret Moore has \$146,800 in income from self-employment and receives \$8,900 in wages that are subject to Social Security taxes. Margaret's net earnings from self-employment are \$135,570 ($\$146,800 \times .9235$). Her net earnings from self-employment subject to OASDI self-employment tax for the year are \$133,900 ($\$142,800 - \$8,900$, the wages on which Social Security tax was withheld), which is less than net earnings from self-employment. Her net earnings from self-employment subject to the HI self-employment tax are \$135,570, the full amount of the net earnings from self-employment. Thus, her total self-employment tax is \$20,535 ($\$133,900 \times 12.4\% + \$135,570 \times 2.9\%$).

The employer portion of the self-employment tax liability for the year is allowed as a deduction on the tax return. This deduction is taken as a deduction from gross income on the front of Form 1040.

EXAMPLE 3.27

Jim Jergens has \$40,000 in self-employment income. His net earnings from self-employment are \$36,940 ($\$40,000 \times .9235$). The self-employment tax is \$5,652 ($\$36,940 \times 15.3\%$). The employer portion of this amount, \$2,826 ($\$36,940 \times 7.65\%$), is allowed as a deduction from gross income.