

Business 101 for Freelancers: Entities, Legal Issues, and Taxes

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Suzy Bills: Hi, everyone. Thanks for joining this session today, Business 101 for Freelancers. Specifically, we're going to be talking about business entities, legal issue—specifically on contracts, getting paid—and also taxes. So with that, let's just get started. I have a lot I want to cover.

We're going to start with business licenses and structure. Okay, so we have a couple business entities that are most common for freelancers. Most freelance editors designers writers, you're going to usually either default to a sole proprietorship ship.

We're going to go over those two first and then I'll explain some other options.

So a sole proprietor, that's what you are as a freelancer by default. You don't have to file any extra paperwork, do any extra steps.

Just by starting your business and doing work, you are a sole proprietor. So a lot of freelancers stay as a sole proprietor because it doesn't take any extra steps and that can work very well.

But there are some benefits that you can get from becoming an LLC. So I'll go into some of those benefits and then we'll talk about how to actually become an LLC. So an LLC is a limited liability company, and so that means that you have some protections. So for example, if for whatever reason, when your clients decide to sue you—maybe because you made an error in a document—then the client could sue your company, the LLC, but would not be able to sue you personally.

So there's some separation there that's giving you the kind of protection of you individually. Similarly, if a client were to sue you and you need to pay money and damages or maybe your business went bankrupt, your personal finances would be protected from that situation. So for example, if your, your company went bankrupt, your business would owe money but you wouldn't have to pay from personal funds, you wouldn't potentially lose your house or have your car repossessed. So there's those protections there, but the time those really aren't, we're not going to have those issues as freelancers, and so we don't need that protection really for those reasons. What I really see the benefit of having an LLC, is that you can get some tax benefits. So you'll reduce your tax liability, as an LLC.

If you then go and file with the IRS as an S corp. So we'll just jump down there really quickly and then we'll return to LLC.

An S corp isn't technically a business entity. It's just a filing status with the IRS. And so we'll go into this later when we talk about taxes, but if you file as an S Corp through the IRS, then you can get some tax deductions.

So let's just jump back to LLCs really quickly. You will need to register with your state. The process differs from state to state, and so you want to figure out what is required for your state. If you just Google LLC Utah or LLC California, it will direct you to the state's website that will give you information on LLCs, and you can file on online. It's a pretty straightforward process. I'm going to give you examples in Utah.

It is \$70 to file; you can have a company file for you, and those companies will charge \$200–\$500. I don't think it's worth it to pay that money because it's pretty simple. I've set up several LLCs and it takes maybe 15 to 30 minutes. It's pretty straightforward, there's usually some explanations of the different information that you need to enter into the field. If you have any questions you can Google information—Nolo (NOLO).com—has a lot of helpful information there. So really, you're going to be okay filing on your own. You don't have to be a business expert, you don't need to have a law degree, to be able to file an LLC.

So in Utah, it's a pretty low fee to file, but in some other states it's quite bigger. So for example in California, it's a lot more expensive. So in those states where it's a hefty fee for an LLC, then you'll maybe say, "Okay, this doesn't really make sense financially to do an LLC, because it's going to cost so much." So you will want to do a little research on your state to figure out whether it's going to be a good fit for you.

So after you initially register—you file your LLC—then there's just a yearly renewal fee. In Utah, it's just \$15.

Some states do require that you complete some extra documentation throughout the year. They might require that you have an annual shareholder meeting (keep minutes of that). Utah doesn't. So again, look at what's required for your state and just make sure you follow those processes.

The other option I have here is a C Corp. It's really not applicable to freelancers, especially if you just plan to remain a sole employee of your company—you're not going to hire other employees—so really you don't need to worry about a C Corp. So your main ones you're going to focus on are sole proprietor or LLC.

There is an option for partnership; if you want to go into business with another writer, for example, then you could do that. It's not as common so we're not going to go over those options.

Alright, no matter the type of business you have, you do need to get a business license, almost in every state. So again, just check with your state, type in name of the state, and then business license, and you'll be directed to the correct website.

So, for example, in Utah the filing fee is going to be \$22–\$52 depending on what your business is—exactly what it's going to be doing—and then the yearly renewal fee is going to be about \$20.

This is an example on the city level: Provo does not require you to have a business license if you don't have customers, clients, coming to your home as part of your business. So most editors, writers, designers, marketers—what you guys are doing—you're not going to regularly be having clients come to your home. So, if you were in Provo, you wouldn't need a business license.

But do make sure that you are looking at your local jurisdiction to see what those rules are, because technically no matter how much money you're making in your business, how regularly, you are taking on projects, if you're doing any kind of business, you should have a business license. If you don't, you could be fined by the government. So that's why you want to have it.

Now let's shift to taxes. So we kind of blew through the business entities, just because it's a little more straightforward. And often people have a lot more questions about taxes. So that's where we're going to spend some more time.

So, one of the things to be aware of as a freelancer is you have the wonderful opportunity to pay a 15.3% self-employment tax. Now if you were employed somewhere, you were only paid half of that because your employer pays the other half of the 15.3%. As a freelancer, you get to pay the full 15.3%.

That is up to a threshold of \$137,700 in 2020; if you make more than that, your percentage that you have to pay decreases, which is nice.

Otherwise you're going to be paying the 15.3% and that's in addition to just the regular income taxes that you're paying.

So it's important to be aware of that. And that's one of the reasons why freelancers need to be charging more than they would be earning if they were just working in-house somewhere, because you have a higher tax percentage that you are required to pay.

So that's important to keep in mind. Luckily, with this income tax self employment tax, 50% of it is deductible on your taxes; now just as a reminder, tax deductions, that's not dollar for dollar deduction, so it doesn't mean that you're going to, if you spend a dollar in self-employment that you can deduct a dollar from self-employment—it's this percentage lower, but it's still decreasing some what you have to get taxed. So it's nice that we get that. The easiest way to estimate how much you're going to have to pay in self-employment tax is to use an online calculator. So just Google "calculators self-employment tax" and you'll find a lot of websites that will have you input some information about your income, etcetera, and they will estimate, hey, this is about how much you can pay in taxes. And you don't really need to know that, it's just to help you know, okay, how much in general do I need to be saving from self-employment tax because as a freelancer, maybe you earn, for example, let's say, \$500 on a project, you think, "Sweet! I just earned \$500!" Well okay, you need to think about, well, I'm going to have to pay the 15.3% in self-employment tax on that, plus just the regular income tax. And so you actually need to just think, I didn't actually earn \$500; I actually earned \$300 or whatever, that would be after the taxes are taken out. So, something to be aware of. And again, that's really, make sure that you are charging enough to cover these costs of being a freelancer; so the cost that you typically wouldn't have to worry about if you're an employee somewhere (so in addition to the self-employment tax, also medical benefits if you're not getting any support from an employer

that way). So make sure that all those extra costs that you are paying as a freelancer, that you're charging enough to cover those things.

Now let's get into how using an LLC with an S Corp can help decrease your tax burden. So as I mentioned, if you, if you file as an LLC and then submit the forms with the IRS to be an S corp, then the IRS will consider you an S corp. And so what that allows you to do, is you pay a little bit less in taxes because of this process I'm going to explain now.

Right, so you are going to pay yourself a reasonable salary. And let's say if I am a writer, and I know that in my geographic area, if I were a writer, then I could earn, for example, \$50,000 as an employee somewhere.

Then that would be my reasonable wage. And if you were only working freelancing part time then you could say, "Okay, if I'm only working 20 hours a week, then my reasonable wage would be 25,000 here," for example.

Alright, so we have our reasonable wage. And then what we do is we, any amount we earn above that reasonable salary, we consider that dividends. So say my reasonable salary is \$50,000 a year and I actually earn \$70,000 a year in freelancing; so I'm taking the \$50,000 as my reasonable salary and the extra \$20,000—that I'm taking as dividends, which are taxed at a lower rate. So a reasonable salary that the team, excuse me, that \$50,000 is subject to the whole 15.3% self-employment tax. The 20,000 above that is taxed at a lower amount. So therefore, my tax liability, how much I have to pay in taxes each year is going to be lower. So that's how you can earn, or excuse me, that's how you can owe less to the IRS through having an LLC, and filing as an S corp. So it sounds awesome, right? There are some things to keep in mind. First, be aware of how much that LLC is costing you in your state. So does that make the money worth it? Second, so you will need to register for an EIN. It's free. It's on just the [irs.gov](https://www.irs.gov); again, companies will offer to file, register an EIN for you. You don't need to pay; it takes maybe five minutes to get an EIN, and it's free. You'll need that for your LLC for the tax filing.

Also be aware that you will need to file an individual tax return and an S Corp tax return, and an S corp tax return is due do on March 15 rather than April 15. Okay, so it's a little bit earlier.

And it's going to take more forms to file, more work, more knowledge. And so it really is beneficial to hire an accountant, a tax preparer, to file your taxes for you because the amount of time you spend filling out all those forms and maybe doing it correctly, maybe not doing it correctly, it's just well worth the money to pay an expert to do it.

And I will say I pay my tax preparer about \$250 to file my taxes and I save thousands of dollars from having an S Corp. So for me it is definitely worth that going with the S corp and have somebody file my taxes for me.

I will often have people ask me, “Well, what’s the threshold? How do I know when I should switch to an, excuse me, an LLC and an S corp, so I can get these tax savings?” I can’t give you just an across the board amount, because it really depends on each person’s situation.

It depends on how much you’re earning per year, whether you are filing jointly with a spouse, what your deductibles are; so, there are lots of variables.

My suggestion would be to talk with a tax preparer and accountant and say, “Hey, here’s my situation.

What, based on my personal situation, what will be the best for me to do? Would it make sense for me to go with an LLC, based on the extra costs that will be involved? Or should I stay as a sole proprietor?” Alright? There are things with, if you are going to go the S corp route, you do need to pay for payroll and bookkeeping services, and that’s just kind of a way to show that, hey, I’m operating above the board. I’m doing things accurately. I am honestly paying myself a reasonable wage and here’s kind of the accounting of it. So you would want to use one of those services and there’s lots of, a lot of services that you can use.

The one other thing with using this method is your Social Security benefits are based on your salary—that is your reasonable salary that you’re declaring—not your total earnings. So, for example, going back to if I said that my reasonable salary was 50K per year, and then my dividends was 20K, my Social Security would be based just on that \$50,000 a year. And so, social security, how it determines how much you receive and Social Security benefits, it looks at those five highest paying years, and it makes an average of those and it looks at a couple of things. But, so it’s really important is looking at how much you made over your career, those five years that you made the most. And so if it’s looking at \$50,000 a year versus \$70,000 a year, then that’s going to affect how much you will receive in Social Security benefits when you reach the age that you can receive them. So again, keep that in mind. My personal opinion is don’t rely on Social Security and make sure that you are contributing to your retirement counts and so that’s really where more of the guarantee is that you’ll have the funds that you need in retirement years. I do want you to know that that is, be aware, that this is a potential downside of using an LLC and filing as an S corp.

Alright, well, let's move on to quarterly taxes. So you probably have heard of these before. And we're going to look at a couple things when you need to pay them, and if you do, and how to go about it.

Okay, you need to make quarterly payments as a freelancer if we have these conditions. You'll own more than \$1,000 in taxes after your standardized or itemized deduction. If so, (if you filed out your) file your taxes on April 13 and it shows the you owe the government more than \$1,000, then you need to have paid taxes quarterly. Also, you need to pay taxes if you work for a company. So maybe you're just freelancing on the side and you have another job, you're an employee somewhere, and the tax withholdings will be less than 90% of them you owe. So there comes time you see that you owe \$1,000 in taxes, and you only paid 80% which would be \$800 and you should be paying them quarterly, instead of waiting until April 15. The other one is if your tax withholdings will be less than your tax liability last year.

So, in most cases, most freelancers should be paying quarterly, especially if you're not paying, or excuse me if you don't work in-house somewhere.

So if that's described you, you need to be paying them, then the quarterly taxes are do on April, June, September and January 15-ish.

The -ish is that if that 15th day of the month lands on a holiday or a weekend, then the due date is extended to that next non-weekend -holiday day, alright.

Again, use an online calculator to estimate how much you are going to need to pay and that will give you an idea.

You'll get even a better idea by completing form 1040-es and it just goes through this stuff. So you'll need last year's tax filing forms.

You'll indicate how much you are planning to make this year. So you're estimating that information and then from that, it'll tell you, "Okay, based on the information you have provided, you need to pay XYZ amount each quarter." Okay. You can pay online. It's pretty simple. And so if that's the one thing about the IRS that we can say is that they make it easy for you to pay them.

And so that the process is pretty easy to do quarterly taxes. Just remind yourself maybe add a reminder in your calendar, the beginning of April, June, September and January to submit your quarterly taxes.

So typically, you're going to pay the same amount each quarter. But what if you, your income changes considerably during the year. Either you're doing a lot more freelancing or you're doing a lot less freelancing.

Well, you just go in and you submit another 1040-es and updating that information and then you adjust how much you pay and those following quarters of the year and if you've gone and done that, you will be okay and you typically won't have to pay penalties. And so penalty is what will happen if you don't pay quarterly taxes during the year, and you were supposed to. So, for example, I'll be honest, my first two years of freelancing, I did not pay quarterly taxes and can't come tax time I filed my taxes and I would owe a little bit and a penalty because I didn't file quarterly, and I should have. So that's the worst that happens if you don't pay quarterly; they don't drag you to jail; you don't get, you know, a criminal record, anything like that.

You don't want to be evading taxes or doing something unethical—that could land you in jail—but if you are just not paying quarterly, the worst that is going to happen is you will have to pay an additional penalty percentage of how much you should have paid earlier in the year. It's a pretty low percentage, so it's not a huge deal if you just don't pay quarterly and you should have. But be aware that you will be paying a little bit more because you're paying that fine.

We have a couple of things that we can do, if you really don't want to pay quarterly taxes. So one simple way is just to look at how much you owed in taxes last year and maybe owed, for example, \$2,000.

So you just divide that before, divide that by four and this year in quarterly taxes you pay \$500 each quarter.

That will save you and you won't have to pay a fine, even if you end up needing to pay more, on April 15, you won't have that penalty there.

Another option is just to increase your withholdings in an in-house position. So either yours or if you're filing with a spouse jointly, then you can increase the withholdings at your spouse's job. So just have instead of the percentage that is typically going to be taken out of your paycheck, have an increased by 10% or have it increased by of whatever percent you need so that it covers the amount of taxes you're required to pay, and so you wouldn't need to be quarterly. So that's another option that you can take.

Let's look at the deductions. This is the part where you just, I feel, you breathe a sigh of relief, you say, "Thank you. Okay, I have so many more tax requirements as a freelancer. At least I get to take some deductions on things." So there are lots of areas that you can take deductions on so take advantage of that. Here's just a list of some examples.

Anything related to marketing or advertising your business (from business cards, to ads, to whatever); banking, accounting, tax preparation fees; health insurance if it's not subsidized by an employer; any computer equipment, software programs, anything that you need to actually complete your work; conferences, so LDSPMA conference—that registration fee is tax deductible; membership to professional organizations; other training; a home office, so you get to take that deduction if you have a part of your home that is set aside for your business.

It can't be the same place. It can't be your couch that people also watch the TV on because that's not set aside for your business. But if you do have a business office or just one section of a room that is only used for your business, then that can be taken as a deduction.

And then, what that means is you can deduct that percentage, you know, if it's say 200 square feet or it's 10% of your home space, then you deduct that 10% of your mortgage or rent, 10% of you utilities, 10% of other home related expenses.

You can also deduct phone and internet service for the amount of the percentage of that you're using your phone and the internet for your business; website costs; business trips (transportation to and from, meals while you're there).

Keep in mind, like I mentioned before deductions are not dollar for dollar so you're not, you know, if you pay \$200 for conference registration. You're not reducing your tax liability by \$200, it's a percentage of that, but still, it's better than nothing, right so again, make sure you that you are tracking all of your expenses, so you have this the log of, here are all the things that I paid for my business. And then you can use them as business deductions. Make sure you save the receipts. That's really important. If you were to be audited, you would want to be able to show proof that these were actually business expenses.

So a couple more suggestions or tips related to this. There's a lot of great information on [irs.gov](https://www.irs.gov) That explains topics, especially for freelancers, self-employed people. There's a lot of good information there. So go ahead and check it out if you have questions. There are also lots of other websites, YouTube videos, that have a lot of good information there. Excuse me.

Also, make sure that you open a business bank account and credit card account. That's essential if you have an LLC, but even if you are a sole proprietor, you should have separate personal and business bank accounts. It helps separate the personal expenses from the business expenses and it shows that separation between your business and your personal.

With credit card, if you ever want to use credit, have a line of credit for your business, you need to have a credit card history for your business, for your LLC. And so that's why it's helpful to have a credit card account, if you have an LLC.

As I mentioned, save all receipts; save them for six years. That's typically the time that you can be audited for a specific year. So you want to have those receipts.

You can either have paper copies of them or have electronic copies of them, you can use programs such as Shoe Box, Evernote, Scanable to scan paper receipts and to file them electronically.

Have a system to keep your business expenses documented. And also your income—you want all that documented. You can go a high tech route; there are online systems that will help you track everything in expenses, income; I go old school and just keep everything in an Excel file. I've done that for more than ten years. Okay, so I can go back years and years and see how my expenses, how my income has changed over the years, and it's all there if I ever need to look at anything. So make sure that you just have a system to keep you organized, they'll become or just be so handy come tax time and it will keep your life a lot simpler.

Now let's go on to our last topic for the session, which is contracts, invoices and payments.

Alright first, contracts. The purpose of the contract is just to ensure that you and the same client have the same expectations. You want to make sure that you both understand each other, so there aren't any surprises later on, especially ones that can lead to legal issues, okay. So that's the main idea.

Also a contract is a protection to you. I like to use the metaphor of you don't lock your house at night, thinking that a thief is going to come every night and try to turn that door knob and get in; you're just locking the door for the one night that that thief comes and you protect yourself. A contract is the same thing.

I believe that most clients are very ethical and they're going to pay you. There are just a few clients who you might have issues with. And of the hundreds of people I have worked with, there

have only been very few who have tried to get out of paying me. Having a contract has helped save me. So it's just one of those precautions, something that will protect you.

So with those two purposes, making sure you have the same expectations as your client and just keeping yourself protected, you want to specify everything about the project. So here's some things to include; word count; parameters of work to be completed. So for example, if you are editing something specify, don't just say substantive editing.

List everything that included in substantive editing. So maybe I'm going to be fixing organization. I'm going to be addressing cohesion and coherence and so I list each of those items in a bulleted list and then it's very clear for both me and the client to know exactly what work I'm going to be doing. And so afterward if the client says, "That's not what I wanted you to do," you can go back to the contract and you say, "Well, this is what it specifies and this what I did." Also, address scope creep. So what happens if the client wants you to do additional work? For example, the editing again—edit more content. So the client gives you five additional pages to edit, and so you want to cap those parameters on what happens if the client is wanting you to do more than initially agreed upon, so have a clause in there to say, "I'm happy to take on extra work and that will be with a new contract or we can renegotiate this contract, but the extra work will incur a new fee." Project due dates both the clients deadline to route or to send you content, and also your deadlines for returning content.

The payment amount method and due dates. I personally charge 50% up front before I will start the work and then 50% when I complete the work.

I found that having the 50%, that helps prevent payment issues later on. So I really recommend requiring 50% up front. You could go a little bit lower, but I found that even if I just do 25%, that tends to have more issues connected with it and getting paid afterward.

Have a clause in there about the late fees. You can just charge a fee, so \$50 per each 30 days late, or you can have a finance charge percentage. But keep in mind, or be aware, that if you have a finance charge then you can't do more than 1% per month. A lot of states have a limit on the percentage that you can charge per month. And so you'll typically be safe within the guidelines if you keep it to 1% or less per month.

Have an expiration date. So, stating when the contract expires, if it has not been signed by the client, so that protects you if you send out a contract in 2020 and the client finally turns it back in, in 2022 and wants you to keep the same prices that you had in that contract, you can say, "Sorry, the contract expired and my rates have increased. And so now the charge is going to be

\$50 more than it was when the initial contract was signed, or when the initial contact was sent out.” Or to say that, hey, I can’t guarantee that this document will be 100% accurate. So if you’re editing, for example, you can say that editing, editors can’t guarantee 100% accuracy. So it’s still up to the author to ensure the accuracy of the content.

If you are doing copy editing, the author to still have a proofreader to go after you, etcetera. Termination: What are the parameters, if either one of you wants to cancel the contract? What’s the timeline, how soon does that need to happen and what are kind of parameters, if the client cancels and you’ve already started on the work, then, for example, you should be paid for the amount of time that you’ve already spent working on the project.

And then finally, after everything else have the author and you, excuse me, just the client and you need to sign a contract, so it should include both persons names, also their address, phone number, email address. So the basic contact information.

All right, let’s go over to invoices really quickly. And so the invoice, just send that out every time that it’s time to be billed.

When I have returned the project and I’m getting my final payment, I include this invoice with the project file and it can be pretty basic; include your business’s name, the date, the services you provided, when the client needs to pay, excuse me, when the client needs to pay them out, and how they can pay—what systems you allow, so is it PayPal or do you require direct deposit, do you take a Venmo, whatever payment systems you allow and also, at the end of my invoice, I have a little sentence saying, you know, I thank you for the opportunity to work with you and I love receiving referrals. So if you know somebody else who could benefit from my services, please have them contact me. That’s a little plug. Sometimes people, clients, don’t realize that you will be happy to receive referrals. So this is just a low key way to let clients know.

There are online invoice systems you can use if you want to. I honestly just have a Word template that I use for my invoices. I enter the product-specific information and then I PDF it and I send it off to the author, or excuse me, the client. I am mainly an editor, so I usually think in terms of authors. Hey. All right. Final thing we’ll talk about are late payments. What do you do if your client has not paid by the due date? So start just small And just resend the invoice. Just check in with them and say, “Hey, I noticed that the payment was due two days ago and you haven’t received, I haven’t received it. So I just wanted to make sure how you sent it.

Did it perhaps get lost in the mail?” And that could be all that’s required. And they say, “Oh, you know, I did forget it. I did forget to send it right away. So it should be in the mail, you should

receive it soon,” or maybe they’ll say, “Oh, I will send it right away.” Sometimes they need a little bit more encouragement, so maybe you need to send multiple invoices and that’s kind of the time when it looks like maybe they are not in a financial situation to be able to pay. And so maybe you need to be persistent and regularly send them invoices, call, offer a payment plan. Sometimes with my clients who haven’t paid I’ve just said, “Okay, let’s create a schedule for when you pay and we break up the amount,” and that, you know, may take me longer to get the payment, but at least I’m going to get the payment and it’s not that the person doesn’t want to pay me, it’s just the person had a financial issue come up that has made paying on time hard.

The final step is to send a demand letter. And that’s basically saying, “Hey, if you don’t pay me, I will take legal action,” And you typically, you don’t want to take the legal action because if you go to a small claims court or go to a collections agency, it’s still hard to get the money. So if small claims court rules in your favor, for example, because you have the contract that shows that you did everything you needed to receive the payment, the small claims court won’t collect the money for you.

At the time that you win the case, you would still have to collect it, for example through a collections agency. If a collections agency is involved, the agency is going to take a percentage of whatever amount you get from the client. And so it’s just kind of a, it’s an ordeal to go through without guarantee that the payments going to come in or easily. So, but sometimes just the fact that you say, “Hey, I will take you to court,” that can be the motivation that the client needs to say, “Okay, I will see you. Or let’s put together a payment plan and I will stick with that plan.” Okay, so that is the end of my presentation. I know that we will now go to q&a. I’m happy to answer any questions you have.

Also, you’re welcome to reach out to me, I will put my email address in the chat so you can get that. But it’s suzy_bills@byu.edu. Also I have a book coming out on freelance editing next year, and so it’s catered to freelance editors but applies to freelancers of all areas, so you can watch out for that as well. Thank you very much I enjoyed speaking with you and I look forward to answering any questions you have. Take care. Bye.