

# Understanding Self-Employment Taxes



**DECAL**  
**Thriving Child Care**  
**Business Academy**

## Understand how to estimate your self-employment tax and make a plan to pay it.

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Understanding Self Employment Tax is critical to child care business owners who operate as sole proprietors, S corporations and any partners related to the business. Businesses who are taxed as “pass-through” businesses, where profit passes through the owner’s personal income tax return are affected by this tax rule.

Self-employment tax includes both Social Security and Medicare taxes that self-employed child care providers must pay on their net earnings. Imagine you run a home-based child care service and your net income for the year is \$40,000. You are responsible for both the employee and employer portions of Social Security and Medicare taxes on this income. This tool will equip you with the knowledge to estimate your tax liability, set up quarterly payments, and avoid penalties, mitigating risk for your business and increasing the accuracy of your tax payments.

### How does self-employment tax work?

Understanding how self-employment tax is calculated is crucial for child care business owners. Self-employment tax is calculated at a rate of 15.3% (for tax year 2023). This comprises two components:

- **Social Security** – 12.4%. The good news is that social security tax applies only to income up to a certain threshold called the Social Security wage base limit (in 2023, \$160,200). Income beyond this threshold is exempt from the Social Security portion.
- **Medicare** – 2.9%. Unlike Social Security, there's no income limit for the Medicare portion. Child care business owners must pay this tax on all their self-employment income.

Therefore, your tax liability or, how much tax you owe, can be easily calculated by multiplying your net income by the tax rate for both social security and Medicare taxes.

It is important to note that self-employment taxes are their own category of tax obligations. Self-employed individuals must also pay income tax on their earnings, which is a separate tax obligation, but which also must be included in your tax payments.

### Example

While completing your budgeting and record-keeping processes, you want to first calculate your net self-employment tax. To find this number, you deduct your business expenses from your business income- simple subtraction. In this example, you find that you have earned more than you've spent and that your net self-employment income, the difference between your income and expenses, is \$40,000. In this case, your self-employment tax calculation would look like this:

	Tax Rate		Taxable Income	Self-Employment Tax Liability
Social Security Tax	12.4%	x	\$40,000	\$4,960
Medicare Tax	2.9%	x	\$40,000	\$1,160
	15.3%		<b>TOTAL:</b>	\$6,120

### Why do I need to estimate taxes?

As a business owner, you need to pay estimated taxes because your income tax is not automatically withheld from your earnings throughout the year. While W-2 employees have their taxes withheld by their employer, self-employed child care business owners are responsible for paying their taxes directly from their earnings, and you must do so by the timeline and schedule set by the IRS.

### Example

Let's say you earned \$8,000 in your child care business during the first quarter of the year. Without estimated taxes, you might not have paid any taxes on this income until the following April, when you be responsible for the tax bill for the entire year and face potential penalties for late payment. Estimating your taxes and making regular payments helps you distribute the tax burden and more accurately understand your personal financial position throughout the year.

### How do I pay my estimated taxes?

Estimated taxes are typically paid in four equal installments throughout the year, aligning with the quarterly due dates. Before making payments, use the worksheets available on [Form 1040-ES](#) to help you calculate your estimated tax liability for your child care

business. Be sure to include any relevant deductions that can reduce your overall tax liability, including using the time/space calculation if you are a home-based business. You can even use your previous year's return to help estimate your income, deductions, and tax liability.

Child care providers have various methods for paying estimated taxes through the IRS. You can make your payments using any of the following methods:

1. **Online** through the [IRS website](#) using your bank account or your debit/credit card. No fees apply to payments made through your bank account and you can schedule payments up to one year in advance. For payments made with a debit/credit card, you can choose from the IRS's three payment processors and can be taken online or on the phone.
2. **Online** through the [Electronic Federal Tax Payment System](#) (EFTPS). This system, managed by the U.S. Treasury Department, allows you to make online or phone payments 24/7. You must enroll online or by phone using a two-step verification process. Once enrolled, you can securely make payments or schedule them in advance.
3. **By mail** using check, money order, or cashier's check. When you pay by mail, you must include the [Form 1040-V](#), or payment voucher, which includes detailed instructions for how to prepare your payment. It is important to note that the IRS does not accept cash payments by mail.

## When do I make my estimated tax payments?

Understanding the quarterly payment deadlines is essential for child care providers. The IRS publishes an [online tax calendar](#) and offers calendar reminders to help you keep on top of your payment schedule.

### Quarterly due dates for estimated tax payments are:

1. April 15th (for income earned from January 1st to March 31st).
2. June 15th (for income earned from April 1st to May 31st).
3. September 15th (for income earned from June 1st to August 31st).
4. January 15th of the following year (for income earned from September 1st to December 31st).

These quarterly payments are considered estimates because you are paying taxes on your assumed income for the year. However, your business may have varying rates of cash flow and profit or loss throughout the year. You can calculate your estimated taxes each quarter based on your estimated annual earnings, ensuring your estimated tax payments align with your actual income and cash flow. To determine your estimated

annual profit, review your cash flow and profit and loss. Subtract your expenses from your revenue, the resulting number is your profit. Then, you can multiply that number by your estimated tax rate (15.3) to find your estimated tax payment, divide that number by four to find the estimated amount per quarter. If you have made tax payments prior to completing this calculation, subtract that payment from your calculated amount to find the estimated taxes remaining. This can be done proactively with estimated figures to help you manage your finances effectively and mitigate a hefty tax bill at year end. By being aware of your quarter tax amount, you can plan for that as an expense in your budget and reduce the risk of underpaying on your taxes.

Another way to relieve the financial burden of your self-employment taxes is to make more frequent withholdings and payments. You can pay your estimated taxes weekly, biweekly, monthly, or at whatever frequency makes the most sense for your business, so long as you are paying your full estimated tax bill by each quarter's deadline.

If your income fluctuates throughout the year, you can avoid or lower penalties by annualizing your income, meaning that you will calculate the total amount of money you will earn in the year, and make unequal payments based on your cash flow each quarter. This allows your quarterly taxes to be based off your annual income, but not place undue stress on your business during lower-earning quarters. You can use this [form](#) created by the IRS to see if there may be a potential penalty for underpaying. If you are concerned about penalties, make this check part of your quarter tax prep routine to reduce risk and stay accurately informed about what is owed.

Are there penalties for not paying taxes on time?

Failure to pay estimated taxes on time can lead to penalties. The IRS can impose penalties if you underpay your estimated taxes throughout the year. These penalties are calculated based on the underpaid amount and how late the payments were made.

### **Example**

If you were required to pay \$1,500 in estimated taxes for the first quarter of the year but only paid \$1,200, you may face a penalty on the \$300 underpayment.

Avoiding penalties can be done in four simple steps:

1. **Complete Form 1040-ES** as accurately as possible to estimate your business income and self-employed estimated tax liability.
2. **Set aside money from your income** on a regular basis, just like an employer withholds taxes from paychecks for W-2 employees. This withholding can happen

at whatever frequency makes sense for your business – weekly, biweekly, monthly, or quarterly.

3. **Pay your quarterly estimated tax bill** in full before each quarter's deadline. Put these deadlines on your calendar so you don't miss them. If you prefer not to pay a lump sum once a quarter, you can pay more frequently using the money you set aside from your earnings.
4. **If your estimated income changes** throughout the year, you can complete another Form 1040-ES to get more accurate estimates as you progress through the year. Do this at least once per quarter if your income is differing from what you expected, to ensure you are not underpaying on taxes.

If you are unsure if you owe penalties, complete [Form 2210](#) to see if you need to file with the IRS for underpayment. If you are concerned about underpayment, penalties, or accurately estimated your taxes, seek professional tax advice.

## Conclusion

Self-employment tax and estimated taxes are vital considerations for child care business owners. By understanding these concepts, accurately estimating your tax liability, and making timely payments, you can successfully navigate your tax responsibilities. Seek guidance from a tax professional or refer to IRS resources and forms if you need assistance. Managing your taxes effectively will ensure you stay compliant with the IRS and avoid unnecessary penalties and stress on your business.

## Additional Resources

**If you have questions or need help, assistance is available.**

[GaPDS Website](#)

[DECAL Thriving Child Care Business Academy Website](#)

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**For questions about coaching or study groups:** Email [GAcoaching@civstrat.com](mailto:GAcoaching@civstrat.com)

**To Find Other ECE Resources:** Visit the [DECAL Website](#)

**For General Questions about the Academy:** Email [thriving@decals.ga.gov](mailto:thriving@decals.ga.gov)

**For More Information:**

[Family Child Care Learning Home Rules and Regulations](#)

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