

FAMILY FINANCES

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Take This Dream and Crunch It

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By KAREN BLUMENTHAL

Working for yourself means freedom -- but it doesn't come free.

Perhaps the greatest advantage of hanging out your own shingle or making that consulting business full-time is the independence that comes with being your own boss. But higher expenses and other costs come along with your newfound liberty. You may not be able to sock away as much pretax for retirement, and you may have trouble refinancing your mortgage. Your higher tax bills may shock you, too.

All in all, if you go out on your own, you may need to bring in up to 20% more than before just to break even, especially if you can't piggyback on your spouse's health insurance, says David Strege, a financial planner in West Des Moines, Iowa.

That doesn't mean you shouldn't try. There are few more gratifying accomplishments than making it on your own. But here's what you should keep in mind as you figure out what to charge for your work and how to budget for your future.

Self-employment is taxing. Gail Rosen, who runs her own accounting firm in Martinsville, N.J., says entrepreneurs in New Jersey pay taxes of 27% to 59% of their net income, including federal, state and payroll taxes. Still, she says, "I am seeing more people than ever before start their own businesses."

Venturing Out

Some steps to take before you hang your own shingle:

Work up a business plan to see how much you need to earn, where your income will come from and what your expenses will be.

Consult an accountant to help you set up your bookkeeping and other systems.

Decide whether you will do business as a sole proprietor, a limited liability company, a partnership or some other way.

Unless it's crucial, forgo renting a fancy office or buying expensive equipment until your business is well under way.

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Negotiating the Freelance Economy

Miscalculate and pay too little, and you will owe penalties to the Internal Revenue Service and maybe your state. In some cities, such as Los Angeles and New York, you may also have to pay local taxes based on your earnings, even if you're a solo contractor.

Without a company behind you, you'll be buying your own office supplies, computers, tech support and, if needed, inventory. You'll need to keep careful records of all your expenses, saving receipts, writing down the mileage you rack up, and noting with whom you dined and when, because all of that can reduce the taxes you pay. If you work from a dedicated office space at home, you could also consider a home-office deduction.

Unintended consequences. While all those deductions will reduce your taxes, they may have

As an employee, you will pay 6.2% of your earnings (up to \$106,800 this year) for Social Security and 1.45% of your income (with no limits) for Medicare, while your employer will pay an equal amount. But when you say goodbye to the Man, you will pay the whole 15.3%.

The good news is that the taxes apply only after you deduct your expenses, and your "employer" half is deductible from your federal taxes. But if your expenses aren't especially high, your total tax costs will go up.

In addition, you'll need to budget carefully and pay estimated taxes four times a year.

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getting a match from an employer, you'll need a fair bit of net income in your new business to be able to contribute an equal amount under one of the various IRS-allowed retirement-plan options, such as a Keogh account or a SEP-IRA. (On the flip side, if you are very successful, you may be able to put as much as \$46,000 in a tax-deferred retirement account.)

Mortgage troubles. If you are planning to buy a home or refinance your current one, lenders will look at your earnings after expenses – not your gross income – to calculate what you are able to pay. Two years ago, self-employed people could get a mortgage with little or no documentation by simply stating their income, and some might still be able to do that today with a down payment of 30% or more of the purchase price.

But for the most part, lenders want at least two years of tax returns to prove your earnings. Even then, says Michael Daversa of Atlantic Residential Mortgage in Westport, Conn., some lenders will average the last two years' income, while others will count only 75% of a self-employed person's income, assuming that business could fall off this year.

Car loans and credit cards, which are based primarily on your credit score, are less likely to be affected by your new job status. Still, Emily Peters, a credit analyst at Credit.com, a credit-card information and comparison Web site, says that you should be aware that your business credit card will show up in your credit report along with your personal cards, even if it has the company name on it.

Ensuring protection. One of the bigger new costs of your new gig may be insurance. You'll need health insurance if your spouse or partner doesn't already have it. Look first to see if trade groups or church affiliations have group plans that you can join.

Cara Lovenson of Plan Professionals Inc., an insurance agency in New York City, says sole-proprietor plans are hard to get and expensive -- perhaps \$400 a month for an individual plan and \$1,200 or more for the family -- with higher deductibles and less coverage than a typical corporate plan.

You may also want professional liability insurance and, if you have an office, a policy to protect you in case of fire or other catastrophe. Disability insurance will protect you if you are unable to work, but it can be costly and will be hard to get until you can prove your income.


Hiring headaches. Accountants and financial planners say your job will grow far more complicated once you start hiring extra help. While health-insurance plans are more plentiful if you have two or more employees, you will also have to pay half the Social Security and Medicare for your workers, withhold federal taxes and decide whether to offer retirement or other benefits. In addition, you'll need to pay for workers' compensation insurance and state unemployment insurance.

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