



A STUDY OF THE EFFECTS OF SELF-EMPLOYMENT TAX AVOIDANCE ON SOCIAL SECURITY BENEFITS OF SOLE PROPRIETORS IN THE UNITED STATES OF AMERICA

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Abstract

This study explores sole proprietors' knowledge and beliefs related to self-employment taxes on Social Security benefits received in retirement in the United States. In particular, the study utilized survey research methodology reaching a sample of 54 business owners recruited from clients of several tax-preparers in the Mid-Atlantic region of the United States. A survey research instrument was created by the investigators and titled Sole Proprietor Questionnaire. The research uncovered a critical lack of knowledge among sole proprietors that could



negatively impact their retirement incomes. Although this study recognizes that tax preparers are not obligated to advise clients on retirement planning, it suggests that they should, at a minimum, consider their potential role in enhancing the financial literacy of sole proprietor clients by providing basic information, as indicated by the study's findings.

Keywords: Sole proprietorship, self-employment, tax avoidance, social security, Medicare

INTRODUCTION

Background of the Problem

The essence of financial freedom in the United States of America is being financially free and ultimately retiring from work with sufficient income to support the remainder of one's life, post-work. To achieve this goal, most people optimize their financial goals by building their financial resources during their working years. The necessary resources may stem from setting up a business or from participating in retirement plans. However, regardless of the means, a strong plan and solid financial knowledge in managing one's resources effectively are required. Participation in any retirement plan may entail purchasing an Individual Retirement Account (IRA) as an individual, participating in one's employer's 401K or 403B retirement plan, participating in Qualified Retirement Plans (Keoghs) or paying taxes on the self-employment net profit of the sole proprietorship income. The taxes paid on the net profit of the sole proprietorship income ultimately increase the sole proprietor's social security benefit.

Millions of small-business owners don't have the benefit of a corporate retirement system. Such people can contribute to an IRA, but the amount they can invest is limited. The alternative for all those doctors, lawyers, real estate agents, artists, writers, and other self-employed people is to establish their own qualified retirement plans (formerly called Keogh plans) Nickels, McHugh, & McHugh, 2024. The advantage of qualified plans according to Nickels, McHugh, & McHugh, 2024, is that participants can invest up to \$66,000 per year. For 2025, the maximum amount an individual can contribute to the Traditional IRA is \$7,000 a year if age is under 50. If age is over 50, individuals can contribute up to \$8,000 per year. For 2026, the maximum amount an individual can contribute to the Traditional IRA is \$7,500 a year if age is under 50. If age is over 50, individuals can contribute up to \$8,6000 per year.

Many people have multiple jobs or businesses providing the basic needs for themselves, family, or friends and at the same time save their excess money to make contributions toward retirement individually or through their businesses if they have one. For sole proprietorship businesses, these basic needs and goals will impact their financial situations after retirement. Kapoor, Dlabay, Hughes, and Hart (2019) stressed that in addition to public and employer

retirement plans, many people choose to set up personal retirement plans. According to Kapoor et al. (2019) such plans are especially important to the self-employed and other workers who are not covered by employer pension plans. Therefore, it seems imperative for sole proprietors to participate in the Social Security Benefit Program even though this may not be enough to cover their needs during retirement.

When a sole proprietor generates a profit from the business, several benefits emanate from the transaction over time depending on how long the business has been in operation and generating net profit. These benefits are, but not limited to,; (1) the sole proprietorship business owner may draw from Social Security benefits at age of 62, 65, 70 or with disability just like a W-2 employee, even though drawing benefit at age 62 is always less than the benefit drawn at the age of 65 or 70, (2) the sole proprietorship business owner may benefit from Medicare at the age of 62, 65, 70 or with disability, (3) the sole proprietorship business owner has the opportunity to contribute toward a retirement source of income while the business owner is still capable of working, (4) the sole proprietorship business owner will be able to enjoy the benefit of Medicare program which is more or less health insurance for those over age 65, 70, or with disability, or low income that cannot obtain health insurance elsewhere due to age and lack of income or low income, (5) the sole proprietorship business owner may be able to receive income from Social Security Administration in case of disability, (6) besides receiving benefit by the Sole Proprietorship business owner, family members such as spouse age 62 or older can receive benefits, (7) benefits can also be paid to unmarried children if they are under age 18 or between 18 and 19 but in elementary school full-time.

The main issue is whether the sole proprietorship owner is aware of all these benefits including how to maximize the benefits by actions taken during the working years.

Purpose of the Research and Research Questions

The purpose of this study was to explore sole proprietors' knowledge and beliefs related to self-employment taxes paid and Social Security benefits in retirement. The research questions that guided this study were:

- RQ1: How knowledgeable are sole proprietors regarding the long-term consequences of paying self-employment taxes now on their total income that they could derive from Social Security benefits during retirement?
- RQ2: What are the characteristic differences between knowledgeable and less-than-knowledgeable sole proprietors concerning the long-term consequences of their self-employment taxes on retirement income? For example, the sole proprietor's age, the age of the sole proprietorship, recent net profit/loss, whether or not the sole proprietors

have a retirement account, and the average percentage of anticipated sources of income during retirement.

- RQ3: What impact do tax preparers have on sole proprietors' knowledge of the long-term consequences of their self-employment taxes on retirement income?

LITERATURE REVIEW

This review of literature will provide information and current knowledge regarding (1) the nature of sole proprietorship, (2) the long-term consequences of the sole proprietor's self-employment taxes paid on Social Security benefits received during the retirement years, and (3) the nature of the relationship and obligations required between tax preparers and sole proprietors.

Nature of Sole Proprietorship

A sole proprietorship business is a business owned by one person. Gitman (2009) defined a sole proprietorship business as a business owned by one person and operated for profit. Similarly, Mariotti (2010) defined a sole proprietorship business as a type of business ownership in which a single individual owns the business, collects all profits from the business, and has unlimited liability for its debt. In the eyes of the law, according to Mariotti (2010), the owner and the business are the same. Bovee and Thill (2019) also defined a sole proprietorship as a business owned by one person although they also stated that such an entity could also have many employees. In Nickels, McHugh, and McHugh (2024), a sole proprietorship business is described as a business owned, and usually managed, by one person, represents about 72% of the United States businesses with earnings of only 6% of the U.S. business receipts.

Many farms, retail establishments, and small service businesses according to Bovee and Thill (2019), are sole proprietorships, as are many home-based businesses, such as those operated by caterers, consultants, and freelance writers. If you are paid for performing any kind of service, from babysitting to website design, without being on a company's payroll, you are legally classified as a sole proprietor (Bovee & Thill, 2019). According to Weygandt, Kimmel, and Kieso (2012), a business owned by one person is generally a proprietorship. In smaller sole proprietorships, the owner often is both the manager and operator of the business. Small service-type businesses such as plumbing companies, beauty salons, auto repair shops, farms, and small retail stores such as antique shops, clothing stores, and used-bookstores are often proprietorships (Weygandt et al., 2012). Usually, according to Weygandt et al. (2012), only a relatively small amount of money (capital) is necessary to start in business as a proprietorship

and the owner (proprietor) receives the profits, suffers any losses, and is personally liable for all debts of the business.

In Neck, Neck, and Murray (2018), a sole proprietorship refers to a person who owns a business but has not formed a separate entity to run it. They also assert that a sole proprietorship business is completely managed and controlled by the owner and the owner is entitled to all the profits that the business makes.

The Legality of a Sole Proprietorship Business

Generally, to operate a business, the business must be registered with the State Government but for a sole proprietorship business, there is no legal requirement to register a sole proprietorship business with the State Government. However, it is advisable to register one with the State Government at a minimal fee. In some jurisdictions, this registration is referred to as registering a trade name. It is important to note however that registering a business is different from applying for a license. A license provides permission to render certain services such as carpentry, flooring, painting, auto mechanic, gun shops, or retail sales license to mention a few.

In many jurisdictions and industries according to Neck et al. (2018), forming a sole proprietorship is relatively simple and sometimes there is no legal filing at all to set yourself up as a business owner. If the business is in an industry and/or a location where licenses or permits are necessary, one may need to pay a nominal fee to obtain the license or permit (Neck et al., 2018). The sole proprietor and the business are treated as one entity and therefore there is only one personal tax return to file which outlines income and expenses using a separate form, Schedule C, to report the business income (Neck et al., 2018). The business income is added to whatever other income one has and is taxed at one's income tax rate (Neck et al., 2018).

The advantage of registering a sole proprietorship business with the State Government is to avoid some technicalities with the Internal Revenue Service during income tax filing. Some of these technicalities include but are not limited to, the legitimacy of business transactions, questions about whether the income is supported by Form 1099 NEC or bank statements or both, questions about whether the transaction is a hobby or for profit, questions about whether the business has been having net profits or net losses for the prior years, questions about whether the business owner can survive with the business income or without the business income. These are the areas that always show a red flag with the Internal Revenue Service when a sole proprietorship business files income taxes at the end of the year.

Limited Liability Corporation – LLC

Generally, there are three major forms of business ownership. As described by Nickels, McHugh, and McHugh (2024), the three major forms of business ownership are (1) sole proprietorships, (2) partnerships, and (3) corporations. Nickels, McHugh, and McHugh (2024) explains that many people do not have the money, time, or desire to run a business on their own. Therefore, when two or more people legally agree to become co-owners of a business, the organization is called a partnership. A corporation is an artificial, invisible legal being created by law. Weygandt, Kimmel, and Kieso (2012), asserted that in 1819, Chief Justice John Marshall defined a corporation as an artificial being, invisible, intangible, and existing only in contemplation of law. A corporation is a legal entity with authority to act and have liability apart from the owners (Nickels, McHugh, and McHugh, 2024). Besides the three major forms of business ownership; sole proprietorship, partnership, and a corporation, there is a “de facto” business called the Limited Liability corporation (LLC). A Limited Liability Corporation (LLC) is a “de facto” form of business that allows the owners who are called members to enjoy the ownership benefits as a corporation or as an individual when it comes to liability issues.

To operate a business as a Limited Liability Corporation (LLC), the business owner must file an Article of Organization with the State government. Since there are three forms of business; sole proprietorship, partnership, and a corporation, an LLC which is a De-Facto business must be converted to either a corporation or a partnership business to determine the ownership benefits that apply. If the LLC is not converted, the Internal Revenue Service (IRS) will recognize the LLC as a sole proprietorship business and the business owner will still enjoy the ownership benefits as an individual when it comes to liability issues.

A corporation can be a C- corporation, a Closed Corporation, or an S-Corporation. To convert an LLC to a C-Corporation, Close-Corporation, or a partnership business, the business owner must file Form 8832- Entity Classification with the Internal Revenue Service. If Form 8832 is approved by the Internal Revenue Service as a corporation, the business owner can be called a stockholder/shareholder and as a partnership, the business owner can be classified as a partner. Converting an LLC to a corporation or partnership allows the owner to enjoy the ownership benefits as a corporation, or as an individual when dealing with business liabilities. If the business is not converted, the State will always recognize the business as a corporation, but the Internal Revenue Service will always recognize the business as a sole proprietorship business, meaning taxing the entity as a Sole Proprietorship Business.

To convert an LLC to an S-Corporation, the business owner must file Form 2553 (Election by a Small Business Corporation) with the Internal Revenue Service. If the business is not converted, the Internal Revenue Service (IRS) will automatically recognize the business as

a sole proprietorship business and the business owner will still enjoy the ownership benefits as an individual when it comes to liability issues.

Corporations

Relative to corporations, a C-Corporation referred to as Conventional Corporation, is a corporation that has many Shareholders/Stockholders, and these shareholders are generally the public, and the shareholders are not liable for the debts or other problems of the corporation. Nickels, McHugh, & McHuch (2024) define a C-Corporation as a state chartered legal entity with authority to act and have liability separate from its owners. Nickels, McHugh, & McHuch (2024) stresses that Stockholders are not liable for the debts or other problems of the corporation beyond the money they invest in the business by buying ownership shares, or stocks in the company. For Tax purposes, a C-Corporation must file the U.S. Corporate Income Tax Return Form 1120 with the Internal Revenue Service every year.

A Closed Corporation is a corporation that has a small number of shareholders/stockholders and it's mostly for family business or a small number of groups of small investors. As per Nickels, McHugh, & McHuch (2024), a closed (private) corporation has stock that is held by a few people and isn't available to the public. Converting a Limited Liability Corporation (LLC) to a Closed Corporation requires the business owner to file the U.S. Corporate Income Tax Return Form 1120 with the Internal Revenue Service every year. If the business is not converted from the Limited Liability Corporation (LLC) to a Closed Corporation, the business is then classified as a sole proprietorship, and the business owner will be required to file a Schedule C: Profit or Loss from Business (Sole proprietorship) with his/her U.S. Individual Income Tax Return Form 1040 every year.

An S-Corporation is a unique government creation that looks like a corporation but is taxed like sole proprietorship and partnership (Nickels, McHugh, & McHuch, 2024). An S-Corporation has a limited number of shareholders. According to the Internal Revenue Code, an S-Corporation cannot have more than 100 shareholders. An S-Corporation is a conduit entity meaning a pass-through entity where the tax activities flow to the owners, called shareholders or stockholder's personal income tax return. The S-Corporation tax status allows the business profits, losses, deductions, and credits to flow directly to the shareholder's personal income tax return Form 1040.

Converting a Limited Liability Corporation (LLC) to an S-Corporation requires the business owner to file the U.S. Income Tax Return for an S-Corporation Form 1120-S. An S-Corporation does not have a tax liability because net profit or loss from an S-Corporation flows directly to the business owner's personal income tax return Form 1040.

Partnership Business

A partnership business is an unincorporated association of two or more people to pursue a business for profit as co-owners (Larson, Wild, & Chiappetta, 2002). Partnership business is especially common in small retail and service businesses. As emphasized by Larson, Wild, & Chiappetta (2002), many professional practitioners also organize their practices as partnerships, including physicians, lawyers, and accountants.

Converting a Limited Liability Corporation (LLC) to a Partnership business requires the business owner to file U.S. Return of Partnership Income Form 1065 every year.

Entrepreneurship

Generally, an Entrepreneurship is a process whereby an individual or a group of individuals create a new business venture at their own risk. Barringer & Ireland (2025) defines an Entrepreneurship as a process by which individuals pursue opportunities without regard to the resources they control currently. Entrepreneurship as described by Barringer & Ireland (2025), is a set of behaviors, rather than a reflection of a company's age, size, industry, or its leader's personality. In addition to new ventures according to Barringer & Ireland (2025), entrepreneurship can occur within large firms, government agencies, and nonprofit organization. Boone, Kurtz, & Canzer (2022) explained that Entrepreneurship is the willingness to take risks to create and operate a business. An entrepreneur is someone with an idea who sees a potentially profitable opportunity and then devises a plan to achieve success in the marketplace (Boone, Kurtz, & Canzer, 2022).

Entrepreneurship is accepting of the risk of starting and running a business (Nickele, McHugh, & McHugh, 2024). Thus, an entrepreneur is someone who creates and runs a business (Mariott & Towle, 2010). When an entrepreneur, according to Mariott & Towle (2010), starts a new business, risk is involved. Risk is the chance of losing something. An entrepreneur is a risk taker. This can be in the form of a sole proprietorship business, partnership business, or a corporation. On this node, an entrepreneurship in this project is classified as a sole proprietorship business whereby an individual (the sole proprietor) takes the risk (the entrepreneur) to pursue an opportunity without regard to the resources he/she controls currently.

Self-Employment Tax Implications for Social Security Benefits

There are two basic ways a person could financially provide for basic needs and at the same time be contributing towards retirement. The person could work as an employee or work as a Subcontractor otherwise called a businessperson or a sole proprietor. If one works as an

employee, the pay which is called employee compensation is subject to payroll taxes such as Federal Withholding Tax, FICA Tax (FICA stands for Federal Insurance Contribution Act) otherwise known as Social Security's Old-Age, Survivors, and Disability Insurance (OASDI) which is commonly called the Social Security Tax, Medicare Tax, State Withholding Tax, and Profit Sharing (401-K) plan or 403-B contribution if the business is a Non For Profit Organization.

However, if the person works as a subcontractor, otherwise called self-employment or sole proprietorship business, the pay received is called Non-Employee Compensation (NEC) and none of the compensation will be subject to any taxation until the person files his or her taxes at the end of the year. The taxes paid on the subcontracting income at the end of the year affects Social Security directly.

Income received as an employee is considered compensation by the Internal Revenue Service and it is classified as salary or wages. The salaries and wages along with the payroll taxes and the employee's contribution of Profit Sharing are reported on a Form W-2 when the employer reports it to the Internal Revenue Service at the end of the year. The information reported on a Form W-2 submitted to the Internal Revenue Service includes Taxable Gross Pay shown on Box 1 as Wages tips, other compensation, Federal Withholding Tax Withheld shown on Box 2, Social Security wages shown on box 3, Social Security Tax withheld shown on Box 4, Medicare Wages and Tips shown on box 5, Medicare Tax Withheld shown on Box 6, State Wages and Tips shown on Box 16, and State Income Tax shown on Box 17. If the employee participates in the employer's Profit-Sharing Plan which is classified as a 401-K Plan or 403-B, the employee's contribution will be shown on Box 12 of Form W-2. The difference between the taxable income in box 1 and Medicare wages and tips Box 5 is always equal to employee's contribution to employer's 401-K profit sharing box 12. The total income subject to Social Security Tax otherwise called FICA Tax on Box 3 changes every year.

For 2025, the maximum taxable social security wages, box 3 of W-2, was \$174,900. The maximum Social Security Tax (FICA Tax), box 4 of W-2 on the income limitation of \$174,900 was \$10,843 at a Tax Rate of 6.20% of the income limitation. For 2024, the maximum taxable social security wages, box 3 of W-2, was \$168,600. The maximum Social Security Tax (FICA Tax), box 4 of W-2 on the income limitation of \$168,600 was \$10,453 at a Tax Rate of 6.20% of the income limitation. For 2023, the maximum taxable social security wages, box 3 of W-2, was \$160,200. The maximum Social Security Tax (FICA Tax), box 4 of W-2 on the income limitation of \$160,200 was \$9,932 at a Tax Rate of 6.20% of the income limitation.

For 2022, the maximum taxable social security wages, box 3 of W-2, was \$147,000. The maximum Social Security Tax (FICA Tax), box 4 of W-2 on the income limitation of \$147,000

was \$9,114 at a Tax Rate of 6.20% of the income limitation. For 2021, the maximum taxable social security wages, box 3 of W-2, was \$142,800. The maximum Social Security Tax (FICA Tax), box 4 of W-2 on the income limitation of \$142,800 was \$8,854 at a Tax Rate of 6.20% of the income limitation. Table 1 provides a hypothetical example of social security tax limits by year showing assumed wages, taxable wage base, and the maximum social security tax from 2024 to 2028.

Table 1: Social Security Wage Base and Maximum FICA Tax by Year

Year	Assumed Gross Wages	Maximum Taxable Social Security Wages Box 3.	Maximum Social Security Tax Withheld 6.20% FICA Tax. Box 4.
2025	\$180,000	\$174,900	\$10,843
2024	180,000	168,600	10,453
2023	180,000	160,200	9,932
2022	180,000	147,000	9,114
2021	180,000	142,800	8,854

Source: Authors-provided figures

Social Security Contributions from Self-Employment Tax

The Social Security Wages in Box 5 of W-2 are classified into FICA Tax (Federal Insurance Contributions Act) and Medicare Tax and have always been subject to Social Security Tax of 7.65% (*Refer to Figure 1 in the Appendix*). Over the years, the Social Security Tax in Box 4 W-2 has been subject to Social Security Tax otherwise called FICA Tax at 6.20% from the 7.65% and Medicare Tax box 6 at 1.45%. The Social Security Wages from Box 3 of W-2 have a cap and the cap increases every year as discussed earlier. On the other hand, one hundred percent of employees' wages box 5 of W-2 are subject to Medicare Tax of 1.45% of the balance from the Social Security tax of 7.65%. This Tax is reported in box 6 of the W-2. When employee contributes 7.65% payroll tax from the employee's income, employer matches the tax dollar for dollar making it a total contribution of 15.30% tax. Thus the 7.65% matched by the employer becomes a benefit to the employee. When the employee retires, the 15.30% tax paid over the years of employment becomes the employee's social security benefits.

For a Sole-Proprietorship business, tax on the Net Profit is not paid until the Sole-Proprietor files his or her tax at the end of the year and the tax is called self-employment tax. The self-employment tax of a sole proprietorship business is also subject to 15.30%. This is because the sole proprietor in this case serves as both an employee at 7.65% and an employer at 7.65% as well.

The compensation received as an independent contractor or a subcontractor, otherwise known as a sole proprietorship business, or a Limited Liability Company (LLC) that is not converted, or an entrepreneurship business operating as a sole proprietorship business, is subject to self-employment tax when the business files its tax return. Thus, the self-employment tax when paid has a direct effect on the sole proprietor's Social Security benefits.

Generally, when an individual performs a service for an organization as a subcontractor or as a sole proprietorship business, whether as an LLC or as an entrepreneurship, the individual receives a Form 1099NEC from the organization at the end of the year for the compensation received. The gross amount of the compensation received from the organization, \$600, is reported to the Internal Revenue Service through Form 1099NEC and it is not always taxed on Form 1099NEC until the recipient files his or her income tax. The recipient (sole proprietor) or the business owner pays the self-employment tax when the income tax is filed on a Schedule C, Profit or Loss from Business which is included in the recipient's U.S. Individual Income Tax Return Form 1040. The information on Schedule C (Profit or Loss from Business) is *Gross Income* less *Operating Expenses* which is equal to *Net Profit* or *Loss* from the business. If the difference is net profit, then, the net profit will be subject to a 15.30% tax just like the Social Security tax from W-2 income of an employee. In this case, the sole proprietor pays Social Security tax of 7.65% tax as an employee and 7.65% tax as an employer based on 92.35% of the net profit from Schedule C if the net profit is more than \$400. Thus, like an employee receiving salary or wage on Form W-2, the sole proprietor will be contributing towards his or her Social Security and Medicare benefits based on the 15.30% tax paid as an employee and as an employer at the same time.

When a sole proprietor generates a net profit from Schedule C every year, the sole proprietor will be contributing toward his or her Social Security benefit through the self-employment tax paid on the business net profit at the rate of 15.30% tax. 12.40% of the 15.30% goes toward Social Security Benefits and 2.90% goes toward the Medicare Benefit which is Health Insurance. In a situation where a sole proprietorship business has not been generating net profit, that means that the business owner will not be contributing to the Social Security Benefit Program, and when the business owner attains the age of 62, 65, 70, or with a disability, there will be no Social Security benefit for the business owner to draw from except Social Security Supplemental Income, which is called the SSI. In this case, the quality of life after retirement from doing business may be jeopardized. The only benefit available will be supplemental Security Income (SSI). The SSI is for low-income or no-income individuals.

In the United States of America according to the Internal Revenue Code, residents and citizens of the United States of America generally must file an annual income tax return based

upon three factors: gross income, filing status, and age. Gross income includes all incomes received in the form of money, goods, property, and services that are not exempt from tax (IRS Code). Gross income also includes income from sources outside the United States of America (IRS Code). U.S. Citizens and resident aliens are taxed on their worldwide income (IRS Code). Generally, according to the IRS Tax Code, nonresident aliens are only taxed on U.S. source income. Filing Status is based on whether a taxpayer is single, married, widow or widower, unmarried but has a dependent (Head of Household), and married filing separately. Age is part of the taxpayer's biographical information that is used to verify the identity of the taxpayer and related dependents if any. Age is also used to determine if a taxpayer qualifies for additional deductions such as age over 65 and over, retirement distributions which is age over 59 ½ without penalty, dependency test, etc. Thus, age is not a factor in determining whether a taxpayer should file tax or not. Age is only a factor in calculating additional credit for a taxpayer. According to the Internal Revenue Code, your income, not age, determines whether you must file taxes at age 17. Over the years, an individual must file a federal income tax return if gross income was above a threshold, net earnings from self-employment were \$400 or more, or he or she is a dependent with more gross income than the standard deduction or with unearned income over \$1,300 in 2024. The standard deduction for a dependent with unearned income was limited to the greater of \$1,300 or the amount of income earned plus \$450 in 2024 Tax Year. For 2024 Tax Year, according to the Internal Revenue Service, the Net Unearned Income (NUI) of a dependent under age 19 (under age 24 for full-time students) at the close of the tax year was taxed to the dependent at the parent's marginal rate and this was referred to as "Kiddie Tax".

The major filing requirement for older taxpayers is based on the overall income of the taxpayer. According to the Tax Cut and Jobs Act (TCJA) for 2018 through 2025, personal exemptions have been eliminated for tax years 2018 to 2025. Filing requirement is now based on the standard deduction of each filing status. An older taxpayer must file taxes if his or her income is greater than his or her standard deduction. For a taxpayer filing married filing separately, the Internal Revenue Service requires taxpayers with a married-filing-separately status from 2019 to file a tax return if his or her gross income was at least \$5, regardless of age. Regarding sole proprietorship businesses, regardless of the Standard Deduction by the Internal Revenue Service, a Sole Proprietorship Business Owner must file income tax if the self-employment net income from Profit or Loss from Business Schedule C is from \$400 or more. The tax on the \$400 is subject to Self-Employment tax at 15.30% of 92.35% of the \$400 which is \$56.52. Generally, Net Profit from the Profit or Loss from Business (Schedule C) for Sole Proprietorship Business is always subject to 15.30% of 92.35% of that Net profit as discussed

earlier. In this scenario, if \$400 is the only taxable income from this business owner, the Self-Employment tax will be \$56.52 as calculated below: Thus the \$56.52 contributes directly toward the Sole-Proprietors Social Security Benefit. Table 2 demonstrates the calculation of self-employment tax.

Table 2: Calculation of Net Earnings and Applicable Self-Employment Tax

Taxable Income from Net Profit or Loss from Business	\$400	x	92.35%	=	\$369.40
Multiply by Self-Employment Tax Rate				x	<u>15.30%</u>
Self-Employment Tax					\$ 56.52

Source: Authors' calculations

Generally, income from Schedule C, Self-Employment Business (Sole Proprietorship) is subject to two taxes, in other words called double taxation. The two taxes are income tax and Self-Employment tax. Therefore, with regards to the standard deduction of a taxpayer, a Single Sole Proprietorship business owner may not pay Income Tax on a \$400 Self-employment income if that was the only income earned because the \$400 is less than his or her standard deduction of \$14,600, in 2024 but will pay Self-Employment Tax on the \$400. However, if the income is more than the standard deduction of \$14,600 in 2024, Self-Employment Tax will be levied on the \$400 separately and Income Tax will be levied on the total amount over the standard deduction. Thus, the tax on \$400 affects directly the taxpayer's social security benefits. The higher the net profit of a Sole Proprietor from Schedule C, Profit or Loss from Business, the higher the Self Employment tax paid by the Sole Proprietor and the Self-Employment Tax directly affects the Social Security Benefit receives by the Sole Proprietor.

In a situation where a Sole-Propriety generates a Net profit from Schedule C every year, that Sole-Proprietor will be contributing toward his or her Social Security Benefit through the Self-Employment Tax paid on the business income at the rate of 15.30% tax. 12.40% of the 15.30% goes toward Social Security Benefit and 2.90% goes toward the Medicare Benefit which is Health Insurance.

Supplemental Security Income (SSI)

In a situation where a Sole Proprietorship business has not been generating net profit, that means that the business owner will not be contributing into the Social Security Program and when the business owner attains the age of 62, 65, 70 or with disability, there will be no Social Security benefit for the business owner to draw from except Social Security Supplemental Income called the SSI. In this case, the quality of life after retirement from doing business may be jeopardized.

The only benefit available will be supplemental Security Income called SSI. The SSI is for low income or no income individuals. According to the Social Security Administration Guide for 2022, Supplemental Security Income (SSI) is a federal income supplement program funded by general tax revenues and not from Social Security taxes. It is designed to help the aged, the blind, and the disabled people who have little or no income. The purpose of SSI according to the Social Security Guide (2022) is to provide cash to meet basic needs for food, clothing, and shelter. For 2022, the Social Security Administration Guide states that you may be able to get SSI if your resources are worth \$2,000 or less and a couple may be able to get SSI if they have resources worth \$3,000 or less. For 2022, the maximum SSI benefit is \$841 per month for eligible individuals and \$1,261 for an eligible couple and \$421 for an essential person.

An essential person is someone who lives with an SSI beneficiary and provides essential care. An example will be a child taking care of a parent, or a live-in caretaker. For 2025, according to the Social Security Administration Guide the monthly payment amount for SSI was \$967 for an eligible individual, \$1,450 for an eligible individual with an eligible spouse, and \$484 for an essential person. For 2026, the Social Security Administration confirmed a 2.8% increase on SSI benefit effective January 2026. The monthly payment amount for SSI in 2026 will be \$994 for an eligible individual, \$1,491 for an eligible individual with an eligible spouse, and \$498 for an essential person.

Estimated Taxes

Most of the time, some Taxpayers consider income tax as a burden and as a result pay minimum or no income tax at all, particularly Sole Proprietorship Business owners. Because of this situation, the Internal Revenue Service requires all taxpayers particularly, Sole Proprietorship Business owners or otherwise called Subcontractors who receive income not subject to withholding income taxes to pay at least 90% estimated taxes on their business income on a quarterly installment basis. If the business was in existence in the previous year, the estimated taxes according to the Internal Revenue Code is based on 100% of the previous year's tax liability or 90% of the current year tax liability. These taxes are paid on a quarterly installment basis as listed below in Table 3.

Table 3: Estimated Taxes Schedule

First Payment Due Date	April 15	Covers January – March Income
Second Payment Due Date	June 15	Covers April – May Income
Third Payment Due Date	Sept, 15	Covers June – August Income
Fourth Payment Due Date	Jan. 15	Following Year Covers Sept. – Dec. Income

Source: Authors' compilation

Generally, in the United States of America, income generated from services provided or sales of goods to the public are subject to taxation according to the Internal Revenue Code. This taxation can be beneficial or detrimental to the taxpayer. However, for Sole Proprietorship business owner, the taxation can be beneficial in the sense that the taxes paid on the Sole Proprietorship income from Schedule C (Profit or Loss from Business) affect directly the Sole Proprietor's Social Security Benefit.

Sole Proprietorship Business Tax and Social Security Benefit

The Sole Proprietorship income tax is reported on Self-Employment Tax called Schedule SE. The self-employment tax is 15.30% of 92.35% of the net profit, as reported on Schedule C (Profit or Loss from Business). The 15.30% tax as compared with W-2 constitutes 7.65% Social Security Tax paid by the Sole Proprietor as an employee of an organization and 7.65% as an employer of the same Organization. In this case, the sole proprietor is both the employee and the employer.

When a Sole Proprietorship business generates a profit for the business owner, several benefits emanate from the transaction over time depending on how long the business has been in operation and generating net profit. These benefits are but not limited to: (1) Sole Proprietorship business owner has the luxury to draw from Social Security Benefit at age of 62, 65, 70 or with disability just like W-2 employee even though drawing benefit at age of 62 is always less than benefit drawn at the age of 65 or 70, (2) Sole Proprietorship business owner has the luxury to benefit from Medicare at the age of 62, 65, 70 or with disability, (3) Sole Proprietorship business owner has the opportunity to contribute toward a retirement source of income while the business owner is still capable of working, (4) Sole Proprietorship business owner will be able to enjoy the benefit of Medicare program which is more or less health insurance for those over age 65, 70, or with disability, or low income that cannot obtain health insurance elsewhere due to age and lack of income or low income, (5) Sole Proprietorship business owner may be able to receive income from Social Security Administration in case of disability, (6) besides receiving benefit by the Sole Proprietorship business owner, family members such as spouse age 62 or older can receive benefits, (7) benefits can also be paid to unmarried children if they are under age 18 or between 18 and 19 but in elementary school full-time.

In addition to receiving income at retirement according to Madura (2020), one will also receive Social Security benefits if one becomes disabled, or if one is the survivor when the breadwinner of the household dies. If the person who qualified for Social Security dies in this case, the household's main income earner according to Madura (2020), the following benefits

are provided to the survivors: (1) a one-time income payment to the spouse, (2) monthly income payments if the spouse is older than age 60 or has a child under the age of 16, and (3) monthly income payments to children under the age of 18 or up to 19 if still attending secondary school full-time. According to the Social Security Administration Guide for 2019, when one dies, the family may be eligible for benefits based on the work credit.

Social Security Work Credit

Social Security work credit is the number of credits a person needs to earn to qualify for Social Security Benefits. Generally, every person earns Social Security Credits every year as they work. The more you work and the higher your earnings, the greater your benefits, up to a certain maximum amount (Kapoor et al, 2019). To qualify for Social Security benefits according to Madura (2020), one needs to build up a total of forty credits from contributing to Social Security over time through payroll taxes.

According to The Social Security Administration Guide for 2019, most people need 40 credits (10 years of work) to qualify for benefits. For a Sole Proprietorship business, same concept applies through Self-Employment Tax. For 2018 according to Madura (2020), you can earn four credits per year if your income is at least \$1,320 per quarter. According to the Social Security Administration Guide for 2019, a taxpayer needs to earn 40 credits, which is equivalent to 10 years of working to qualify for Social Security benefits. For 2019 according to the Social Security Administration Guide for 2019, you can earn one credit for each \$1,360 in earnings up to a maximum of four credits per year. For 2020, for each \$1,410 you earn, you receive one Social Security Credit up to four credits per year. Credit is earned quarterly. For a Self-Employed according to The Social Security Administration Guide for 2020, if your net earnings are \$5,640 or more, you earn the yearly maximum of four credits which means one credit for each \$1,410 of earnings during the year. Younger people need fewer credits to be eligible for disability benefits or for their family members to be eligible for survivor's benefits when the worker dies according to Social Security Administration Guide for 2019.

Social Security Retirement Benefits

Income received from Social Security after retirement constitutes Social Security Benefits. You can receive retirement benefits starting at age 62 (Madura, 2020). According to Madura (2020), the amount of income that one receives from Social Security when one retires is dependent on the number of years that one earns income and the average level of income earned and this is called Social Security work Credit as discussed earlier. Social Security replaces about 40% of a worker's average annual income from his or her working years. Most

people can begin collecting Social Security benefits at age 62 according to Kapoor et al (2019). However, the monthly amount at age 62 will be less than it would be if the person waits until full retirement age. Thus, according to Kapoor et al (2019), this reduction is permanent. According to the Social Security Administration Guide for 2019, the amount of your average wages that Social Security retirement benefit replaces varies depending on your earnings and when you choose to start benefits. For 2020 according to the Social Security Administration Guide for 2020, the full retirement age is 66 if you were born from 1943 to 1954.

Full Retirement Age

For full retirement benefit based on age according to the 2020 Social Security Administration Guide, if you were born in 1953 or earlier, you are already eligible for your full Social Security benefit (2020 Social Security Administration Guide). The full retirement age increases gradually if you were born from 1955 to 1960 until it reaches 67. For anyone born 1960 or later according to the 2020 Social Security Administration Guide, full retirement benefits are payable at age 67. Please see the chart below that lists the full retirement age by year of birth.

Early Retirement

For early retirement according to the 2020 Social Security Administration Guide, you can get Social Security retirement benefits as early as age 62. However, we will reduce your benefit if you retire before your full retirement age. For example, if you turn age 62 in 2020, your benefit would be about 28.3 percent lower than it would be at your full retirement age of 66 and 8 months. Some people will stop working before age 62. But if they do, the years with no earnings will probably mean a lower Social Security benefit when they retire (2020 Social Security Administration Guide).

Social Security Disability Benefits

Social Security Disability Benefit is the benefit receives when one is unable to work due to physical or mental impairment. The Social Security Administration Guide for 2020 stresses that if one cannot work because of a physical or mental condition that is expected to last at least one year or result in death, one may be eligible for Social Security disability benefits. To qualify for Social Security Disability Benefits, one has to contribute to Social Security Benefits. According to Madura (2020), if one is disabled, one may receive some income from the Social Security Administration. The income is determined by the amount of Social Security contributions one makes over time (Madura, 2020). If you are a worker who pays into the Social

Security system according to Kapoor et al (2019), you are eligible for Social Security funds if you become disabled. Thus, how much you get depends on your salary and the number of years you have been paying into Social Security (Kapoor et al, 2019).

According to the Social Security Administration Guide for 2020, if you can't work because of a physical or mental condition that is expected to last at least one year or result in death, you may be eligible for Social Security disability benefits. However, as Social Security Administration warns according to the Social Security Administration Guide for 2020, our disability rules are different from private or other government agency plans. Qualifying for disability from another agency or program does not mean you will be eligible for disability benefits from us. Having a statement from your doctor saying you are disabled does not mean you will automatically be eligible for Social Security disability benefits (Social Security Administration Guide for 2020).

Social Security

Social Security is a federal program that taxes people during their working years and uses the funds to make payments to the people after they retire subject to age and other requirements (Madura, 2020). According to Madura (2020), Social Security is intended to ensure that one receives some income after retirement and therefore is an important part of retirement planning. In Kapoor, Dlabay, & Hughes (2009), Social Security is described as the most widely used source of retirement income; it covers almost 97 percent of U.S. workers. Many Americans according to Kapoor, Dlabay, & Hughes (2009), think of Social Security as benefiting only retired people. But it is a package of protection, providing retirement, survivors', and disability benefits as asserted by Kapoor, Dlabay, & Hughes (2009). Today more than 50 million people, almost one out of every six Americans, collect over \$608 billion in some kind of Social Security benefit (Kapoor, Dlabay, & Hughes (2009). Kapoor et al (2019) asserts that Social Security may be best known as a source of retirement income, but it also provides disability benefits. In Phillips (2020), it is stated that the Social Security Act of 1935 provides retirement income to qualified workers and their spouses after working a certain number of hours. Employees and the employers according to Phillips (2020) both make mandatory contributions to the Social Security system. Benefits can be claimed beginning at age 62, although starting to collect benefits at a later age increases the amount received (Phillips, 2020). DeCenzo, Robbins, & Verhulst, (2016) explains that Social Security provides a source of income for American retirees, disabled workers, and surviving dependents of workers who have died. Social Security according to DeCenzo, Robboms, & Verhulst (2016) also provides some health insurance coverage through the federal Medicare program.

Social Security insurance is financed by employee contributions matched by the employer and computed as a percentage of the employee's earnings (DeCenzo, Robbins, & Verhulst, 2016). In Verhulst & Decenso (2019), it is stated that Social Security provides a source of income for American retirees, disabled workers, and surviving dependents of workers who have died. Social Security according to Verhulst & Decenso (2019) also provides some health insurance coverage through the federal Medicare program. As stated in Verhulst & Decenso (2019), Social Security Insurance is financed by employee contributions matched by the employer and computed as a percentage of the employee's earnings. In 2018, for instance, according to Verhulst & Decenso (2019), the rate was 6.2 percent for employees and 6.2 percent paid by the employer on the worker's earnings up to \$128,400.

Additionally, as stated by Verhulst & Decenso (2019), 2.9 percent is assessed for Medicare on all earned income and similarly to Social Security, employer and employee split this assessment, paying 1.45 percent each in payroll taxes. These rates are still the same up to date except that the income threshold increases every year. While Social Security Tax still remains 7.65% over the years, the maximum Social Security Taxable Wages for 2018 was \$128,400, \$132,900 for 2019, \$137,700 for 2020, \$142,800 for 2021, \$147,000 for 2022, \$160,200 for 2023, \$168,600 for 2024, and \$174,900 for 2025. Thus, the maximum Social Security Tax on taxable income over \$128,400 in 2018 was \$7,960.80, for 2019 was \$8,239.80, for 2020 was \$8,537.40, for 2021 was \$8,853.60, for 2022, was \$9,114.00, for 2023, was \$9,932, for 2024, was \$10,453, and for 2025 was \$10,843. All at 6.20% Tax. There is no income limitation on Medicare Tax. Medicare Tax is at 1.45% of total income on box 5 of W-2.

For a Sole Proprietorship Business, the same concept applies except that the Sole Proprietor finances both the employee portion of Social Security and the employer's portion at 15.30% rate. Thus, the Sole Proprietor in this case serves as an employee and at the same time serves as an employer. This makes the Sole Proprietorship business owner qualify for the same benefits that an employee qualifies for, depending on the longevity of each party's contributions into the system. Therefore, for a Sole Proprietorship Business, it is highly imperative for business owners (Sole Proprietors) to contribute towards Social Security Program so that they can also benefit from the system as an employee of a Business. Social Security does not provide sufficient income to support the lifestyle of most individuals (Madura, 2020). However, a Sole Proprietorship Business owner who does not live a flamboyant lifestyle will be receiving a Social Security check after retirement that can be used to provide for his or her basic needs.

Documentation Needed to Apply for Social Security Benefits

To apply for Social Security Benefits, certain documents are needed according to the Social Security Administration Guide for 2019 and 2020. These documents are:

1. Your Social Security Card
2. Your Birth Certificate
3. Your Children's Birth Certificates and Social Security numbers (if you are applying for them)
4. Proof of U.S. Citizenship or lawful immigration status if you (or a child) weren't born in the United States
5. Your spouse's birth certificate and Social Security number if they are applying for benefits based on your earnings
6. Your marriage certificate (if signing up on a spouse's earnings or if your spouse is signing up on your earnings.
7. Your military discharge papers if you had military service, and
8. Your most recent W-2 form, or your tax return, if you are self-employed.

History of Social Security

Social security is broad terminology. The word social, according to the Webster's Dictionary is a synonym relating to society or organization, or community. Webster's Dictionary describes the word *social* as living together in communities or relating to communal living or relating to society.

Security on the other hand denotes safety, protection, secured, free from danger or free from any predator. Therefore, Social Security can be defined as a way of protection against any distress or danger in society or in the community. This distress can be physical, lack of basic needs, or financial or economic danger. Physical security or distress can be like an intruder breaking into the house while the family is sleeping, or a bear or other wild animal breaking into the house, or an occurrence of a severe snowstorm, or wildfire, or famine and severe drought. Basic needs will be a security against the basic human needs such as food, shelter, clothing, and basic medical needs. Financial or economic security is financial protection for individuals and families after retirement. In this study, Social Security has been defined and analyzed based on economic or financial security of individuals and their families after retirement.

Social Security connotes measures for economic security under governmental auspices (Myers, 1975). Myers (1975) asserts that some individuals hold a very broad concept of social security, considering it to include such diverse programs as public education, vacations with pay, community organization and planning, counseling services, school lunch programs,

research in health problems, and so forth. Generally, however, according to Myers (1975), social security is defined as including only a more restricted scope of programs, namely, (1) those providing cash payments to persons and families whose income from earnings has ceased or diminished, either temporarily or permanently; (2) those furnishing medical care to persons and families receiving benefits under item 1 or, under certain circumstances, to all persons of a given category; and (3) those providing cash payments in respect to all children of a given category, regardless of the presence or absence of parents who could support such children, and regardless of whether such support is being given or in what quantity.

The Social Security Act was signed into law by President Franklin D. Roosevelt on August 14, 1935, based on the proposals put together by the Committee on Economic Security that was formed by President Franklin D. Roosevelt in 1934-1935 (Myers, 1975). These proposals according to Myers (1975) included among other things, social insurance provisions for temporary disability benefits on the pattern of state unemployment insurance programs and for permanent disability benefits under the national old-age benefits program, that federal grants should be made available to state programs providing medical care for the needy- both those receiving cash public assistance payments and those who were medically indigent. It was also recommended that the states, with federal financial and technical assistance, should establish plans to meet medical costs on a prepayment basis. Such plans according to Myers (1975) would be financed, at the state level, with general taxes and/or contributions from the people covered.

Types of Social Security

Social Security is classified into two categories namely Old-Age, Survivors, Disability Insurance which is abbreviated as OASDI, and it is commonly called Social Security. The purpose is to provide income to retirees, surviving spouses and children, and disabled workers. According to Myers (1975), Old-age benefits are payable for life after attainment of a certain age, often with certain requirements as to retirement. Survivor benefits are payable after the death of the breadwinner, either for life or for a period of years (Myers, 1975). According to Myers (1975), Disability benefits, sometimes known as invalidity benefits, are payable generally during the continuance of permanent and total disablement.

The second category of Social Security is Medicare. Medicare is our country's basic health insurance program for people age 65 or older and for many people with disabilities (2019 Social Security Administration Publication). According to the 2019 Social Security Administration Publication, Medicare should not be confused with Medicaid. Medicaid is a health care program for people with low income and has limited resources. State health and human services offices

or social services agencies run the Medicaid program. Some people qualify for just one program, while others qualify for both Medicare and Medicaid.

Medicare

Medicare is a Federal Government health insurance program. As per Social Security Administration Guide for 2022, Medicare is our country's federal health insurance program for people age 65 or older. People younger than age 65 with certain disabilities, permanent kidney failure, or amyotrophic lateral sclerosis (Lou Gehrig's disease), can also qualify for Medicare. The program helps with the cost of health care, but it does not cover all medical expenses or the cost of most long-term care. Social Security Administration Guide for 2022 recommends that you have choices for how you get Medicare coverage. If you choose to have Original Medicare (Part A and Part B) coverage, you can buy a Medicare Supplement Insurance (Medigap) policy from a private insurance company. Medigap covers some of the costs that Medicare does not cover such as copayments, coinsurance, and deductibles.

As per Social Security Administration Guide for 2026, If you have Medicare drug coverage (Part D), your yearly out-of-pocket Part D drugs will be capped at \$2,100 in 2026. Kapoor et al (2019), explained that Medicare is a federally funded health insurance program available mainly to people over age 65 and to people with disabilities. Medicare program provides health insurance to individuals who are 65 years of age or older and qualify for Social Security benefits, or who are disabled (Madura, 2020). According to Madura (2020), Medicare also provides payments to health care providers in case of illness. Medicare is the health insurance portion of Social Security for retirees age 65 or older and disabled workers (Gowan & Lepak, 2020). According to Gowan & Lepak (2020), Medicare is the second part of the FICA tax and became law in 1965. Kapoor et al (2019) describes Medicare as the best-known government health program. Medicare has four parts according to Kapoor et al (2019). These four parts are: hospitalization (Part A), Medical Insurance (Part B), Medicare Advantage Plan (Part C), and Prescription Drug Coverage (Part D).

Medicare Part A: Hospital Insurance

Medicare Part A consists of hospital insurance and is used to cover expenses associated with inpatient care including surgeries in hospitals or nursing facilities and a limited amount of home health care (Madura, 2020). Social Security Administration Guide for 2022 asserts that in Medical Part A (hospital insurance), you usually don't pay a monthly premium for Part A coverage if you or your spouse paid Medicare taxes while working for certain amount of time. This is sometimes called premium-free Part A. According to Kapoor et al (2019), medical

Hospital Insurance is funded by part of the Social Security payroll tax. Part A, which is hospital insurance, helps pay for inpatient hospital care, inpatient care in a skilled nursing facility, home health care, and hospice care. According to Kapoor et al (2019), program participants pay a single annual deductible. Medicare Part A, which is for hospital insurance according to the Social Security Administration Guide for 2019 and 2020 helps pay for inpatient hospital care and certain follow-up services.

According to Madura (2020), there is no additional premium required for Part A coverage for individuals who qualify because they or their spouse paid sufficient Medicare taxes while working. In the Social Security Administration Guide for 2020, it is stressed that most people get Part A when they turn 65. According to the Social Security Administration Guide for 2020, you qualify for it automatically if you are eligible for Social Security or Railroad Retirement Board benefits. Or you may qualify based on a spouse's (including a divorced spouse's) work. Others qualify because they are government employees not covered by Social Security, who pay the Medicare tax. In addition, if you get Social Security disability benefits for 24 months, you will qualify for Part A. If you get Social Security disability benefits because you have amyotrophic lateral sclerosis (Lou Gehrig's disease), you do not have to wait 24 months to qualify. Also, someone with permanent kidney failure who requires dialysis or kidney replacement qualifies for Part A if they have worked long enough or is the spouse or child of a worker who qualifies (Social Security Administration Guide for 2020). Social Security Administration recommended that if you do not meet these requirements, you may be able to get Medicare hospital insurance by paying a monthly premium. For Sole Proprietorship Business, sufficient Medicare taxes is the 15.30% tax paid on the taxable income from Self-Employment Tax Schedule SE.

Medicare Part B

Medicare Part B according to Madura (2020) represents optional medical insurance and it covers some expenses that are not covered by Part A such as outpatient hospital care, physical therapy, and some home health services. Medicare Part B (medical insurance), as explained by the Social Security Administration Guide for 2022, helps cover medically necessary doctors' services, outpatient care, home health services, durable medical equipment, mental health services, and other medical services. According to the Social Security Administration Guide for 2022, Part B also covers many preventable services.

Kapoor et al (2019) asserts that Medicare Insurance Part B helps pay for doctors' services and a variety of other medical services and supplies that are not covered or not fully covered by Part A. Part B according to Kapoor et al (2019), has a deductible and a 20 percent coinsurance provision. Medicare medical insurance is a supplemental program paid for by

individuals who feel that they need it and according to Kapoor et al (2019), a regular monthly premium is charged. For 2019 according to the Social Security Administration Guide for 2019, the standard monthly premium was \$135.50 and for 2020 according to the Social Security Administration Guide for 2020, the standard monthly premium was \$144.60 and some people with higher incomes pay higher premiums. The Social Security Administration Guide for 2020 states that almost every person that is eligible for Part A can get Part B. This is because part B is optional and usually requires monthly premiums.

Medicare Part C

Medicare Advantage Plan (previously known as Part C) according to the Social Security Administration Guide for 2022, includes all benefits and services covered under Part A and Part B, plus prescription drugs and additional benefits such as vision, hearing, and dental, bundled together in one plan.

Medicare Part C represents a combination of Parts A and B and it is provided through private insurance companies that are approved by Medicare (Madura, 2020). In many cases according to Madura (2020), Part C plans identify specific doctors or hospitals that one must use. According to the Social Security Administration Guide for 2022, anyone who has Medicare Part A and Part B can join a Medicare Advantage plan. Medicare Advantage plans according to the Social Security Administration Guide for 2022 include:

- Health Maintenance Organization (HMO) plans.
- Preferred Provider Organization (PPO) plans.
- Private fee-for-service (PFFS) plans.
- Special Needs Plans (SNPs).

In addition to Medicare Part B premium as indicated by the Social Security Administration Guide for 2022, the individual might have to pay another monthly premium because of the extra benefits that the Medicare Advantage plan offers.

Health Maintenance Organization (HMO) Plans

Health Maintenance Organization (HMO) is a health insurance plan that directly employs or contracts with selected physicians and other medical professionals to provide health care services in exchange for a fixed, prepaid monthly premium (Kapoor et al, 2019). According to Kapoor et al, (2019), HMOs are based on the idea that preventive services will minimize future medical problems. This is because HMO plans typically cover routine immunizations and checkups, screening programs, and diagnostic tests. HMO also provides customers with coverage for surgery, hospitalization, and emergency care.

Health Maintenance Organization (HMO) is a health insurance plan that covers health care services approved by doctors; a primary care physician provides general health services and refers patients to specialists as necessary (Madura, 2020). Patient participating in an HMO, according to Madura (2020), normally choose what is called their “primary care physician.” These Patients would need to see their primary care physician to get a referral before they can see a specialist or other health care provider. The purpose of this policy is that the primary care physician can reduce overall health care costs by eliminating unnecessary patient visits to specialists.

An advantage of HMOs according to Madura (2020), is that they offer health care services at a low cost. This is because HMO believes that if they emphasize on early detection and treatment of illnesses, they could keep the premiums relatively low. A disadvantage of HMOs according to Madura (2020), is that individuals must choose among the primary care physicians and specialists who participate in the plan. Thus, patients cannot select a physician who is not approved by the HMO. HMO members typically pay lower premiums in exchange for less flexibility (Madura, 2020).

Preferred Provider Organization (PPO) Plans

Preferred Provider Organization (PPO) is a medical expense plan that contracts with physicians, hospitals, and other healthcare providers to provide covered medical services to policy holders at discounted fees (Rejda, McNamara, & Rabel, 2020). Under a Preferred Provider Organization (PPO) plan according to Rejda, McNamara, & Rabel (2020), a policyholder can elect to receive care from any physician or healthcare provider. However, if a preferred provider is used, the policyholder pays lower deductible and coinsurance charges. If the policyholder receives care outside the network according to Rejda, McNamara, & Rabel (2020), he or she must pay substantially higher deductible and coinsurance charges.

Madura (2020) describes Preferred Provider Organization (PPO) plan as a health insurance plan that allows individuals to select a health care provider and covers most of the fees for services. According to Madura (2020), a referral from a doctor is not required to visit a specialist. A Preferred Provider Organization (PPO) plan is thus a combination of a fee for service policy and an HMO policy (Madura, 2020).

Kapoor et al (2019) describes Preferred Provider Organization (PPO) as a variation on the HMO where a group of doctors and hospitals agree to provide specified medical services to members at prearranged fees. According to Kapoor et al (2019), PPOs offer discounted services to employers either directly or indirectly through an insurance company. The premiums for PPOs are slightly higher than the premiums for HMOs as Kapoor et al (2019) asserted.

Private Fee-For-Service (PFFS) Plans

A Private Fee-For-Service (PFFS) Plan is a type of Medicare Advantage Plan (Part C) that is offered by private insurance companies. The plan determines how much it will pay doctors, other healthcare providers and hospitals, and how much the patient must pay when he or she gets care. Private Fee-For-Service (PFFS) Plans are offered by private insurance companies that are contracted with Medicare. Out-of-pocket costs for each service vary by plan and provider (Internet).

Special Needs Plans (SNPs)

Special Needs Plans (SNPs) is a type of Medical Advantage Plan (Part C) that limits membership to people with specific diseases or characteristics (Internet).

Medicare Part D

Medicare Part D provides coverage for prescription drugs (Madura, 2020). The Part D component according to Madura (2020) can vary among insurance plans in terms of the specific drugs that are covered, the amount of coverage per type of drug, and the deductible. One must have Parts A and B of Medicare to qualify for Part D (Madura, 2020). According to the Social Security Administration Guide for 2019, anyone with Medicare Part A or Medicare Part B is eligible for prescription drug coverage. Medicare Part D is optional, and one will pay an extra monthly premium for the coverage as Social Security Administration Guide for 2019 asserted. Some people with higher incomes pay higher premiums states Social Security Administration Guide for 2019. Thus, many people get their Part D coverage through a Medicare Advantage plan as concluded by Social Security Administration Guide for 2019.

According to the Social Security Administration Guide for 2020, anyone who has Original Medicare (Part A or Part B) is eligible for Medicare prescription drug coverage (Part D). Part D benefits according to the Social Security Administration Guide for 2020, are available as a stand-alone plan or built into Medicare Advantage, unless you have a Medicare private fee-for-service (PFFS) plan. The drug benefits work the same in either plan according to the Social Security Administration Guide for 2020. Joining a Medicare prescription drug plan is voluntary, and you pay an extra monthly premium for the coverage as concluded by the Social Security Administration Guide for 2022.

Medicaid

Medicaid is a health care program for people with low income and limited resources (Social Security Administration Guide for 2019). The Social Security Administration Guide for

2022 explained that Medicaid is a state-run program that provides hospital and medical coverage for people with low income. Each state has its own rules about who is eligible and what Medicaid covers. Some people, according to the Social Security Administration Guide for 2022, qualify for both Medicare and Medicaid.

The Medicaid program provides health insurance for individuals with low incomes and those in need of public assistance (Madura, 2020). Madura (2020) asserted that Medicaid is intended to provide health care to the aged, blind, disabled, and needy families with dependent children. To qualify for Medicaid according to Madura (2020), individuals must meet some federal guidelines, but the program is administered on a state-by-state basis. Individuals who qualify for Medicare according to Madura (2020) may also be eligible for Medicaid if they need public assistance; in this case, they will receive more health benefits. Kapoor et al (2019) describes Medicaid as a well-known government health program classified as a medical assistance program that is offered to certain low-income individuals and families. Medicaid is administered by states, but it is financed by a combination of state and federal funds (Kapoor et al (2019).

Unlike Medicare, according to Kapoor et al (2019), Medicaid coverage is so comprehensive that people with Medicaid do not need supplemental insurance. Typically, Medicaid benefits include physicians' services, inpatient and outpatient hospital services, lab services, skilled nursing and home health services, prescription drugs, eyeglasses, and preventive care for people under the age of 21 (Kapoor et al (2019).

The Tax Preparer and the Sole Proprietor

Technically, in the Internal Revenue Circular No. 230 (Rev. 6-2014) and Internal Revenue Service Statements on Responsibilities in Tax Practice, No. 1, 1988 Rev (1991), there is no clause that states categorically that tax professionals are obligated to recommend or advise tax clients regarding retirement funding. As a result, the advice and recommendations given by tax practitioners are based on the individual tax practitioner's personal experience and knowledge of each tax client's situation. This personal knowledge of the tax client's tax situation can be based on the experience, exposure, and educational background of the tax professional. Tax practitioners should know how to serve their tax clients diligently by providing tax services. Tax service includes preparing tax returns, tax advice and planning, and representing tax clients before government agencies (Weygandt et al., 2012).

If sole proprietors lack the knowledge of the effect of the self-employment tax paid and the long-term consequences on retirement income as revealed in this study, it is then obvious that the findings are extremely alarming, and it has obvious practical implications for both sole proprietors and tax practitioners as well.

METHODOLOGY

Research Design and Data Collection

The applied research study was a non-experimental research design that utilized survey research methodology. With the use of the survey instrument, the investigators attempted to explore the knowledge of the sole proprietors concerning their understanding of the long-term consequences of their self-employment taxes paid and how these taxes impact the retirement income that they will receive via their Social Security benefits.

Several tax preparer professionals associated with the principal investigator were concerned about the perceived lack of knowledge of the sole proprietors that they service. Therefore, participants for this study were recruited directly from the tax preparers' sole proprietors' client lists. From a pool of 80 sole proprietors, this convenience sampling method yielded 54 business owners (68% response rate) from the client lists of several tax-preparers in the Mid-Atlantic Region of the United States.

Due to the specific purpose of this study a survey research instrument was created by the investigators and titled *Sole Proprietor Questionnaire*. This instrument measured the following: (1) three quiz-type questions specifically designed to measure the sole proprietor's knowledge of their current self-employment taxes paid and its effect on their retirement income, (2) the frequency of the tax-preparers communication efforts with the sole proprietor's regarding these matters, (3) the sole proprietor's current source of income as well as their anticipated sources of retirement income, (4) whether or not the sole proprietor currently has a retirement account, (5) the sole proprietor's net profit or loss situation from recent years, and (6) several demographic related questions. The survey was anonymous, and the responses were collected online via Qualtrics and analyzed by an independent analyst not associated with the tax preparer professionals. Consent was provided by the participants on the opening page of the *Sole Proprietor Questionnaire* in the online portal. Recruitment of the research participants was achieved through each tax preparer sending an email to their sole proprietor clients.

Sole Proprietorship and Respondent Characteristics

The industries represented among the respondents were diverse and included the following: accounting and financial services; auto sales and service; hair salons; e-commerce; construction and home improvement; consultation services related to education and law; multiple health-related businesses including pharmacy, fitness, and home care; general services industries; training and development; and transportation. Diversity was also seen in the number of years that the sole proprietorship has been in existence. The age of the businesses ranged from one year to 35 years with an average of 13 years. Thirty-three percent of the organizations

were between one and seven years old, while 27.8% were from 8 to 21 years old. The remaining 16.7% were from 22 to 35 years old. Again, these figures represent a broad and diverse group of businesses.

The net profit or loss situation among the respondents was also normally distributed with the largest proportion of respondents (35.2%) claiming an *average* net profit within several recent years. However, the overall split between profit (70%) and loss (30%) favored profit.

The research participants could also be characterized as broad and as diverse as their small businesses. The gender split was 52% male, 35.2% female, and 13% preferring not to state. The age of the sole proprietors ranged from 20 to 79 years old with an average of 51 years (standard deviation of 10). Sixty-one percent (61%) were between the ages of 40 and 59. Approximately 60% indicated that they were married with 20% stating that they had never been married. The small remaining respondents were either separated or divorced.

Another characteristic that was measured was the source of the sole proprietor's current income. This data assisted the investigators in better understanding the proportion of sole proprietors that relied solely upon their small businesses versus those who relied primarily upon some other employer. We discovered that 32% of the respondents were relying exclusively (100%) on their income from their small businesses. All other percentage splits were small and more evenly distributed.

One somewhat alarming characteristic that we discovered related to the percentage of sole proprietors who currently have a retirement account. The investigators found that 43% of the respondents do not currently have a retirement account. There are several implications of this *characteristic* that will be discussed in the discussion section.

FINDINGS OF THE STUDY

Knowledge of the Sole Proprietors

From research question one, the investigators were seeking to determine the level of knowledge that sole proprietors had regarding the long-term consequences of their current payment of self-employment taxes on the income that they will receive in their retirement years through their Social Security benefits. The survey contained three specific *quiz-like* questions to measure their knowledge, and the respondents were asked to choose the correct response among the possible choices. They were also given the option to state that they were not sure of the answer. This choice was provided to discourage respondents from simply guessing the correct response. A Cronbach's alpha was run, and it was determined that there was internal reliability among the three questions ($\alpha = .800$). The percentages relating to their responses are contained in Table 4.

Table 4: Sole Proprietors' Knowledge

Responses	Question 1	Question 2	Question 3	M (SD)
Correct	27.8%	22.2%	35.2%	28.4% (6.5%)
Incorrect or Did not Know	72.3%	77.8%	64.8%	71.6% (6.5%)

Source: Authors' compilation

Overall, the lack of knowledge among the sole proprietors was evident and alarming. However, to better understand the nuances of this clear lack of knowledge, the investigators were concerned about the differences in characteristics between those who were knowledgeable and those who were less-than-knowledgeable (as explored in research question two).

Knowledgeable versus Less-than-knowledgeable Sole Proprietors

From research question 2, the investigators were exploring characteristics of sole proprietors based on their knowledge of how taxes paid now impact their Social Security benefits during retirement.

Based on the three quiz-like questions that we asked the sole proprietors, we were able to divide them into two distinct groups for analysis. Business owners who got one question or less correct, we classified as “less-than-knowledgeable.” On the contrary, for business owners who answered two or more questions correctly, we identified them as “knowledgeable.” Next, in research question two we were seeking to determine if there were any characteristic differences between these two classified groups. Some differences were detected (see Table 5).

Using an independent samples *t*-test, the analysis determined that knowledgeable sole proprietors were approximately seven years older than their less-than-knowledgeable counterparts, $t(45) = 2.74$, $p = 0.004$ (Cohen's *d* of .735 indicated a moderate effect). Similarly, there was a difference of seven years in the average age of the sole proprietorship between the knowledgeable ($M = 17$ years) and less-than-knowledgeable ($M = 10$ years), $t(40) = 2.12$, $p = 0.03$ (Cohen's *d* of .672 indicated a moderate effect size). It stands to reason those slightly older and more experienced sole proprietors who have been in business longer than their younger counterparts would be more knowledgeable, but this does lessen the substantial gap between these two different groups of people.

Table 5: Less-than-knowledgeable versus Knowledgeable Sole Proprietors

	Less-than-knowledgeable	Knowledgeable	Finding
Average age	49 years old (SD = 10)	56 years old (SD = 9)	Significant Difference
The average age of business	10 years (SD = 9)	17 years (SD = 10)	Significant Difference
Net profit situation	Reported Profit (69%), Reported Loss (31%)	Reported Profit (94%), Reported Loss (6%)	Approaching Significant Difference
Has retirement account	Yes (53%), No (47%)	Yes (69%) No (31%)	No Significant Difference
The average percentage of total income in retirement expected from a Retirement account	M = 23% (SD = 22%)	M = 34% (SD = 28%)	No Significant Difference
The average percentage of total income in retirement expected from SS Benefits	M = 40% (SD = 27%)	M = 45% (SD = 24%)	No Significant Difference

Additionally, a chi-square test of independence was performed to examine the relationship between the reported *net profit situations* of knowledgeable versus less- than-knowledgeable business owners. By mere proportion, 94% of the knowledgeable reported an overall profit versus 69% of the less-than-knowledgeable reported the same. Similarly, only 6% of the knowledgeable reported a loss as compared to 31% of the less-than-knowledgeable reporting a loss. The relationship between these variables was approaching significance, $\chi^2(1, N = 48) = 3.77, p = .052$. A Cramer's V effect size (.280) indicated a medium effect. So, not only are the more knowledgeable older, and have owned their sole proprietorship businesses longer, but they also tend to be more profitable than their less-than-knowledgeable counterparts.

While a greater proportion of the knowledgeable sole proprietors currently have a retirement account (69%) as compared to the less-than-knowledgeable (53%), this

difference was not significant, $\chi^2(1, N = 54) = 1.20, p = 0.274$. However, the investigators were alarmed that 47% of the less-than-knowledgeable do not currently have a retirement account. We also found no difference in the percentage of total retirement income expected to come from a retirement account between the two groups, $t(24) = 1.45, p = 0.159$. In addition, the analysis indicated no significant difference between the two groups concerning expected total retirement income coming from Social Security benefits, $t(33) = 0.68, p = 0.503$. However, the investigators were again alarmed that both groups are expecting 40% (less-than-knowledgeable) to 45% (knowledgeable) of their total retirement income to come from SS benefits.

The Tax Preparers' Impact upon Knowledge

From the research question 3, the investigators explored the extent to which sole proprietors reported that their tax preparers discussed the long-term consequences of their self-employment taxes upon their Social Security benefits (income) that will be received in retirement. For all respondents, there was an even split between the three responses: never discussed (29.6%), sometimes discussed (33.3%), and frequently discussed (37.0%). However, these figures were more revealing when we compared the differences between the knowledgeable and less-than-knowledgeable (See Table 6).

Table 6: Tax Preparer Discussing Long-term Effects of Self-employment Taxes on Income During Retirement

	Less-than-knowledgeable	Knowledgeable
Rarely	79% (30)	25% (4)
Frequently	21% (8)	75% (12)

Note: $\chi^2(1, N = 54) = 14.05, p < 0.001, Cramer's V=0.510, large effect$

Seventy-nine percent (79%) of the less-than-knowledgeable reported that their tax preparers *rarely discussed* the long-term consequences as compared to the knowledgeable with 25% reporting the same. Similarly, 75% of the knowledgeable reported *frequent discussions* with their tax-preparers regarding the long-term consequences as compared to 21% of the less-than-knowledgeable reporting the same. The difference between these two groups was statistically significant, $\chi^2(1, N = 54) = 14.05, p < 0.001$ (Cramer's V effect size of 0.510 indicated a large effect).

SUMMARY OF THE FINDINGS

The investigators surveyed sole proprietors and amid the questionnaires were three relatively straightforward questions that assessed whether sole proprietors were knowledgeable of the fact that 100% of the self-employment taxes paid on net income from the business would be accessible to the individual during retirement via Social Security benefits. Strikingly, approximately 72% of the respondents did not know this basic fact. This represents a critical lack of knowledge among sole proprietors that could negatively impact their retirement income. Frankly, this finding confirmed to them what they had originally anticipated and which was the impetus for this study. However, what we were less confident about was the impact that tax-preparers might have on this knowledge and the ethical implications for tax-preparers who have sole proprietor clients. Before jumping to this important implication, more of the findings will be summarized and discussed.

To better understand the similarities and differences among the knowledgeable and less-than-knowledgeable sole proprietors, we initially wondered if age or the average age of the business were factors that might shed light on what we came to understand was that a substantial knowledge gap. Interestingly, we discovered that the average age difference for both the sole proprietor and the age of the business was seven years. After discussion, all investigators believed that these differences, while statistically significant, were simply more descriptive and seemed logically plausible that these differences might reflect experience and greater business maturity.

As the saying goes, "Knowledge is money"; this does seem to be the case for more knowledgeable sole proprietors as 94% reported their businesses within the past several years were operating with net profit as opposed to a net loss situation. In addition, only 6% indicated a net loss position. On the contrary, of the less-than-knowledgeable sole proprietors, 69% claimed they were operating in a net profit position while 31% stated that they were struggling within a net loss context. While there is no way to plausibly tie knowledge of one very critical fact to a sole proprietor's net income situation, this finding does in some manner reflect the potential power of knowledge and the benefits of knowledge applied to impacting net financial gain.

The next set of questions, while finding no statistically significant differences between the knowledgeable and less-than-knowledgeable, are worthy of highlighting. These three questions revolved around (1) whether the sole proprietor has a retirement account, (2) the average percentage of total income in retirement they expect from their retirement account, and (3) the average percentage of total income in retirement they were expecting to receive from Social Security benefits. Most respondents did claim to have retirement accounts and the investigators believed that their estimation of the total income expected was somewhat

reasonable. However, we felt that the responses to the third question were highly problematic because we had already established a substantial knowledge gap regarding the source of such income. Essentially, 71.6% of the less-than-knowledgeable respondents, not knowing that their self-employment taxes were the source of such income, it was astounding that these same individuals are anticipating that 40% of their retirement income to come from this Social Security benefit. Quite possibly, there will be many sole proprietors who are surprised at the potential paucity of their retirement income coming from these Social Security benefits; especially the ones whose sole source of income is the sole proprietorship.

Without any doubt, while the findings above have shed some nuanced light on sole proprietors and their understanding of their current actions impacting their retirement income, the most substantial finding from this study is the positive impact that tax preparer professionals can have on sole proprietors' retirement income. Table 3 above is crystal clear; 75% of the knowledgeable sole proprietors stated that tax preparers have *frequently discussed* the long-term effect of self-employment taxes on income in their retirement. An even greater percentage (79%) of the less-than-knowledgeable sole proprietors state that their tax preparers have *rarely discussed* these same long-term effects.

IMPLICATIONS FOR TAX PREPARERS

The most substantial implication of this study relates to the impact that tax preparer professionals can have in assisting and educating their sole proprietor clients regarding the long-term effects of their clients' self-employment taxes. This critical lack of knowledge among sole proprietors could negatively impact their retirement income. Thus, sole proprietors' lack of net profit from self-employment income may reduce sole proprietors' Social Security benefit during retirement since self-employment tax paid on net profit affects Social Security benefit. The net loss from self-employment business over time will prevent sole proprietors from contributing to the Social Security benefits.

A very typical reality emerges whereby the sole proprietor desires their tax preparer to do everything in their power (and ethically) to help reduce the tax liability, and rightly so. But maximizing every potential loophole and reducing the self-employment taxes paid on an annual basis will minimize the realization of income during retirement. It is critical for sole proprietors to understand this reality and to plan accordingly for financial viability in their retirement years of life. Our study concludes by offering three specific recommendations for tax preparers regarding their sole proprietor clients.

- Recommendation #1: Ethically speaking, Tax Practitioners must be aware of the reality and proactively involved in advising tax clients, particularly sole proprietors, on how they could fund their retirements while they are still working.
- Recommendation #2: Sole Proprietors should be made to understand by the Tax Practitioners that the self-employment tax paid on net profits over time increases their Social Security benefit.
- Recommendation #3: Tax Practitioners should include in their consulting services how to educate sole proprietors regarding contributions toward their Social Security benefits.

While tax preparers are not obligated to advise clients on retirement planning, it may be worthwhile for them to consider the role they can play in improving sole proprietors' understanding of basic information related to retirement funding, as highlighted in this study.

LIMITATIONS AND FUTURE RESEARCH

The most notable limitation of the study was the limited sample size. A larger and more geographically dispersed sample size would allow for greater external validity and therefore more assurance of generalizability of the study to the population. In addition, we did not collect demographic information related to whether the sole proprietorships in the study were the primary sources of income for the sole proprietors. Knowing whether the sole proprietorship was more of a "side job" versus the major and primary source of income would have been helpful. We were less than interested in the practices of sole proprietors who viewed their sole proprietorships as a "side job" and would have excluded them from this study.

Future research could extend this study in several ways. First, studies that utilize larger and more geographically diverse samples would enhance external validity and strengthen the generalizability of the results. Second, it would be valuable for subsequent investigations to gather more detailed demographic information, particularly regarding whether the sole proprietorship represents the proprietor's primary source of income. Distinguishing between businesses operated as a secondary or supplemental endeavor and those functioning as the owner's main livelihood could offer important insights and provide clearer context for key findings.

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APPENDIX

Figure 1: Sample 2025 W-2 Form

22222		Employee's social security number 123-45-6789		OMB No. 1545-0029	
a Employer identification number (EIN) 12-3456789		1 Wages, tips, other compensation 178,000.00		2 Federal income tax withheld 10,500.00	
c Employer's name, address, and ZIP code Self Employment Inc. 1234 Self Employment Way Dover, DE 12345		3 Social security wages 174,900.00		4 Social security tax withheld 10,643.00	
		5 Medicare wages and tips 180,000.00		6 Medicare tax withheld 2610.00	
		7 Social security tips		8 Allocated tips	
d Control number		9		10 Dependent care benefits	
e Employee's first name and initial Last name Suffix Jane Publicx 890 Business Street Dover, DE 12345		11 Nonqualified plans		12a <input type="checkbox"/> 2000.00	
		13 <input type="checkbox"/> <input checked="" type="checkbox"/> <input type="checkbox"/>		12b	
		14 Other		12c	
				12d	
f Employee's address and ZIP code		15 State wages, tips, etc. 178,000.00		17 State income tax 9,450.00	
16 State Employer's state ID number DE 12-3456789		18 Local wages, tips, etc.		19 Local income tax	
				20 Locally with	

Form **W-2** Wage and Tax Statement **2025** Department of the Treasury—Internal Revenue Service
Copy 1—For State, City, or Local Tax Department