PLANNING TIPS FOR GIG WORKERS

There was a time when the term “gig” referred to employment of a limited duration in the theater or music industry. Now, gig is used to refer to an entire portion of the U.S. economy.

The “gig economy” is made up of workers who may perform services for multiple enterprises throughout the year for varying lengths of time. They are different than traditional employees working full-time, year-round and typically work as independent contractors or freelancers.

Gig workers have a number of financial challenges before them. Since their earnings can be inconsistent, gig workers may need to plan ahead more than their traditional counterparts when managing their money. As self-employed individuals, they must keep on top of paying taxes and may have to secure health and disability insurance on their own. And finally, gig workers should not ignore planning for their retirement and may want to open a tax-favored retirement plan to help them save for the future.

Creating a Workable Budget
As with someone in the theater or music industry, a gig worker’s employment and compensation may unfold in a very unpredictable pattern during the year. To manage their money successfully, gig workers need to impose as much order on this randomness as is possible -- and having a workable budget can help.

A good starting point is to establish a baseline of essential monthly living expenses such as rent, utilities, and groceries. Additional line items in the budget should include amounts allocated for savings, taxes, and nonessential expenses. Next, track income as it comes in. Once several months have passed, patterns for income (or lack thereof) may become evident. Keeping a record of actual day-to-day spending (i.e., a money diary) for a few months can help identify where money is currently going and the nonessential expenses that could be reduced in hard times.

Saving for a Rainy Day
Like their counterparts with traditional jobs, workers in the gig economy should anticipate that something is going to happen to disrupt their finances from time to time. Without an emergency fund -- money set aside specifically for unexpected expenses or the loss of income -- individuals often find that they’re forced to pay bills with expensive credit card debt. As a rule of thumb, it’s wise to have at least three to six months of expenses in a savings account or other easily accessible emergency fund. But, depending on their situation, gig workers may want to have more. If gig workers have a reasonable idea of when there will be dip in income, for how long, and the amount of money that will be needed to survive that period, then they will have a guide by which they can determine how much of their current income they need to put aside as emergency funds for the future.

Keeping on Top of Taxes
Since gig workers are their own bosses in many ways, they need to be particularly aware of the taxes they are responsible for paying. Typically, they’re required to make estimated tax payments to the IRS during the year. These estimated tax payments generally include both income tax and self-employment tax. (State estimated tax payments may also be required.)

Self-employment tax covers the funding of Social Security and Medicare. Similar taxes are withheld from the pay of traditional workers, and their employers also pay a share. The self-employment tax rate is 15.3%, which breaks down to 12.4% for Social Security and 2.9% for Medicare. An additional Medicare tax rate of 0.9% applies to wages, compensation, and self-employment income above a threshold amount.
Estimated taxes generally should be paid in four equal quarterly installments. But if income is received unevenly during the year, required estimated tax payments may not be the same for each period under the IRS’s “annualized income installment method.” The IRS can charge an underpayment penalty if a taxpayer does not pay enough estimated tax for the year or does not make payments on time or in the required amount. As always, gig workers should consult a tax professional if they have any questions about which taxes need to be paid, what the amounts are, and what forms need to be used.

Securing Health and Disability Insurance
In addition to budgeting for basic monthly expenses and taxes, gig workers may also need to put aside money for health and disability insurance payments.

There are several potential sources for health coverage. One is to get coverage under a spouse’s plan. Another is to explore extending coverage from a previous employer using the COBRA program. This kind of coverage, however, may be costly and would only be possible for a limited period, usually 18 months.

Additional resources for coverage include organizations such as the National Association for the Self-Employed (www.nase.org) and government programs such as HealthCare.gov, where gig workers can enroll through the individual Health Insurance Marketplace, as well as find out if they qualify for tax credits and other savings. Bear in mind that coverage through the Marketplace would be based on estimated net income for the year. For income tax purposes, self-employed individuals are allowed a deduction for the cost of health insurance.

Gig workers may also want to investigate getting disability insurance, just in case they are unable to work due to an illness or injury. Gig workers can purchase disability insurance through a number of insurance companies.

Choosing a Retirement Plan
Gig workers usually cannot participate in a company retirement plan. However, this does not prevent them from planning for their retirement, since there are several tax-favored retirement plan options available to the self-employed. These include:

- **One-participant 401(k) plan.** Sometimes marketed as a “solo 401(k)” or “uni-k,” this plan is simply a 401(k) that is geared toward an individual. Gig workers can make up to $57,000 in contributions during 2020, and an additional $6,500 in catch-up contributions if they are 50 years of age or older. Additional contribution limits apply.

- **Simplified Employee Pension (SEP) plan.** A SEP plan allows gig workers to direct a portion of their earnings into an individual retirement account (IRA). The maximum contribution is 25% of earnings or $57,000 (whichever is less) for 2020. SEPs do not offer a catch-up contribution option.

- **Traditional or Roth IRA.** For 2020, gig workers can contribute up to $6,000 to all their IRAs, plus an additional $1,000 if they are age 50 or older.

Gig workers should consult their tax and financial professionals for help in deciding which retirement option is best suited to their needs and for additional planning assistance.