S-Corporation Strategy

REDUCE INCOME SUBJECT TO SELF EMPLOYMENT TAX

Many businesses start out as sole proprietors filing taxes on Schedule C of their 1040. Once the business is profitable, the taxpayer is subject to Self Employment (SE) Tax on the total profits of the business at a rate of 15.3%. Often, the taxpayer owes more in SE than they do in income tax!

Forming a corporation or LLC for the business and choosing to have it taxed as an S-Corporation allows the owners to reduce the SE tax. An S-corporation pays no taxes itself. Income "flows through" to the shareholders and is taxed at the individual level. This flow through amount is NOT subject to SE tax.

o for example if you had a business that had net income of $80k and it was taxed as a sole proprietor, the entire amount would be subject to SE tax or approximately $13k. If that net income was from an S-Corporation it would NOT be subject to the SE tax.

But here is the catch. The IRS says that a shareholder of a corporation must pay themselves a reasonable salary. This wage is subject to FICA tax which is effectively the same rate as the SE tax. So in the above example, if the owner took $40k in wages, the remaining $40k in net income would NOT be subject to SE tax, saving them $6k per year.

ACTION ITEMS AND NEXT STEPS

CORE

- Form Corporation or LLC: Consult a Lawyer or do it yourself.
- Make S-Corporation election using IRS Form 2553: Filing deadlines apply for use during current tax year.
- Setup Owners's Salary on Payroll: Make sure salary is reasonable, and all applicable federal and state payroll forms are timely filed.