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S Corporation Tax Savings

I have, on a number of occasions, written about the benefit of being an S corporation versus being an LLC. The time has come to remind my clients of differences between the two.

Note that I am not talking about the benefits of an S corporation over a sole proprietorship. No business should be a sole proprietorship because this structure has unlimited personal liability.

The main difference between an S corporation and an LLC is the payment of payroll taxes (Social Security). The amount of income tax paid by an S corporation or LLC will be the same. Moreover, the income tax is owed whether the money is drawn out of the business or left in the business.

An LLC that has a member who actively participates in the business will pay Social Security tax on the entire amount of net income from the business, whereas an S corporation will only pay Social Security taxes on the actual salary that is drawn.

The question arises then, "Well, to really reduce my Social Security tax, why can't I give myself a salary of \$0?" The IRS is looking for a minimum salary before distributions can be taken. The S corporation has to take a minimum salary of somewhere between \$45,000 and \$75,000 and is based on what salary you would have to pay someone to replace yourself in the business.

The additional cost of electing to the S corporation status includes payroll taxes and the additional cost to complete an S corporation tax return. The enclosed chart details the additional costs and tax savings at various income levels.

The disadvantage of electing to become an S corporation and taking a lower salary is the reduced amount of Social Security earnings you will accrue. Therefore, reducing your social security benefit at retirement.

The goal of paying reduced payroll taxes is to accumulate more cash flow to help with temporary cash flow needs of the business. Also, the goals will be to put more money in retirement plans (401(k)s, IRAs, etc.).

| | | S | Corporation | LLC | Difference |
|-------------------------------------|-------|-------------|-------------|---------|--------------|
| Income From business | | | | | |
| before owners | | | | | |
| compensation | | | 50,000 | 50,000 | |
| W-2 Wages | | | (50,000) | - | |
| Income | | | - | 50,000 | |
| | | <u>Rate</u> | | | |
| Social security taxes | | 12.4% | (6,200) | (6,200) | |
| Medicare taxes | | 2.9% | (1,450) | (1,450) | |
| Unemployment tax | | | | | |
| State | 8,500 | 2.5% | (213) | | |
| Federal | 7,000 | 0.6% | (42) | | |
| Total Payroll taxes | | | (7,905) | (7,650) | 255 |
| Costs for completing S corp return | | | (1,000) | - | 1,000 |
| Total payroll taxes and tax filings | | | (8,905) | (7,650) | 1,255 |

| | | S | Corporation | LLC | Difference |
|-------------------------------------|-------|-------------|-------------|----------|----------------|
| Income From business | | | | | |
| before owners | | | | | |
| compensation | | | 75,000 | 75,000 | |
| W-2 Wages | | | (60,000) | - | |
| Income | | | 15,000 | 75,000 | |
| | | <u>Rate</u> | | | |
| Social security taxes | | 12.4% | (7,440) | (9,300) | |
| Medicare taxes | | 2.9% | (1,740) | (2,175) | |
| Unemployment tax | | | | | |
| State | 8,500 | 2.5% | (213) | | |
| Federal | 7,000 | 0.6% | (42) | | |
| Total Payroll taxes | | | (9,435) | (11,475) | (2,041) |
| Costs for completing S corp return | | | (1,000) | - | 1,000 |
| Total payroll taxes and tax filings | | | (10,435) | (11,475) | (1,041) |

| | | S | Corporation | LLC | Difference |
|-------------------------------------|-------|-------------|-------------|----------|----------------|
| Income From business | | | | | |
| before owners | | | | | |
| compensation | | | 100,000 | 100,000 | |
| W-2 Wages | | | (60,000) | - | |
| Income | | | 40,000 | 100,000 | |
| | | <u>Rate</u> | | | |
| Social security taxes | | 12.4% | (7,440) | (12,400) | |
| Medicare taxes | | 2.9% | (1,740) | (2,900) | |
| Unemployment tax | | | | | |
| State | 8,500 | 2.5% | (213) | | |
| Federal | 7,000 | 0.6% | (42) | | |
| Total Payroll taxes | | | (9,435) | (15,300) | (5,866) |
| Costs for completing S corp return | | | (1,000) | - | 1,000 |
| Total payroll taxes and tax filings | | | (10,435) | (15,300) | (4,866) |

| | | S | Corporation | LLC | Difference |
|-------------------------------------|-------|-------------|-------------|----------|----------------|
| Income From business | | | | | |
| before owners | | | | | |
| compensation | | | 250,000 | 250,000 | |
| W-2 Wages | | | (75,000) | - | |
| Income | | | 175,000 | 250,000 | |
| | | <u>Rate</u> | | | |
| Social security taxes | | 12.4% | (9,300) | (13,652) | |
| Medicare taxes | | 2.9% | (2,175) | (7,250) | |
| Unemployment tax | | | | | |
| State | 8,500 | 2.5% | (213) | | |
| Federal | 7,000 | 0.6% | (42) | | |
| Total Payroll taxes | | | (11,730) | (20,902) | (9,173) |
| Costs for completing S corp return | | | (1,000) | - | 1,000 |
| Total payroll taxes and tax filings | | | (12,730) | (20,902) | (8,173) |