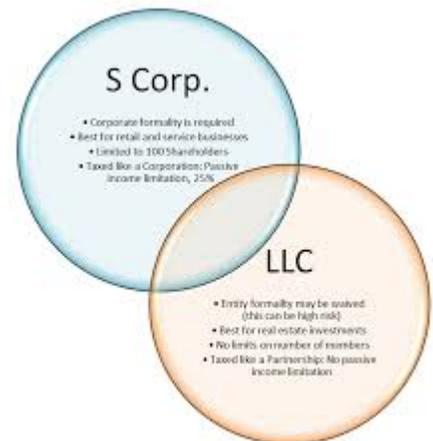


S Corp Election Self-Employment Taxes



S Corp Election

Posted June 26, 2018

There is a misconception floating around out there that an S Corp is a standalone entity. Not true. There are three basic business entities with variations within. The three basic are-

- Limited Liability Company (LLC)
- Limited Liability Partnership (LLP) or General Partnership (GP)
- C Corporation including Professional Corporation (some states require attorneys, accountants and doctors, for example, to be a Professional Corporation)

Two notables missing from the list. First, sole proprietors are not an entity nor is the variant "Doing Business As" (DBA). If you wake up and want to sell used copiers, you can, right now, without any formalized structure. It is not smart, but certainly permissible. At times sole proprietors are interchanged with single-member limited liability companies (SMLLC) since the IRS and most states consider a SMLLC to be a disregarded entity for taxation, and both a sole proprietorship and a SMLLC will end up on Schedule C of your Form 1040. However, they are truly different in several underlying ways.

Also note how an S corporation is not listed. It is not an entity. It is a taxation election. The underlying entity has to be one of the above, and usually it is an LLC (either single-member or multi-member) for the ease of formation.

So while we might talk about your 'S Corp', or 'S Corp Taxes', we are truly talking about your underlying entity being treated as an S Corp for taxation. Again, this is a common misconception... no biggie if you thought otherwise.

Avoid Self-Employment Taxes

A common complaint from those who own their own business is self-employment tax. Can you avoid, reduce, eliminate or lower your self employment taxes or SE taxes? Yes, to a large extent actually but it takes some effort and an S Corp Election.

If you own a business as a garden variety single-member LLC (one owner or shareholder), your business income will be reported

on your personal tax return under Schedule C and is subject to self-employment tax (currently 15.3%) **and** ordinary income tax. The same is true for a business that has not formed a corporation such as a sole proprietor and partnerships. So, you could easily pay an average of 40% (15.3% in SE taxes + 25% in income taxes) on all your net business income in Federal taxes. Wow!

S Corp Election

If you own an LLC and have elected to be treated as an S corporation (Subchapter S) for taxation, the business now files a corporate tax return on Form 1120S. What's the big deal? Before we get into that, let's look at some quick numbers. These are based on using a salary of 40% of net business income for incomes up to \$500,000 and then decreased incrementally to 30% for the millionaire at \$2,500,000 below (real case actually)-

Income	Total SE Tax	Salary	Total PR Tax	Delta	Delta%
30,000	4,239	12,000	1,836	2,403	8.0%
50,000	7,065	20,000	3,060	4,005	8.0%
75,000	10,597	30,000	4,590	6,007	8.0%
100,000	14,130	40,000	6,120	8,010	8.0%
150,000	18,711	60,000	9,180	9,531	6.4%
200,000	20,050	80,000	12,240	7,810	3.9%
300,000	22,972	120,000	18,174	4,798	1.6%
500,000	29,991	200,000	20,494	9,497	1.9%
750,000	38,764	262,500	22,307	16,457	2.2%
1,000,000	47,537	350,000	24,844	22,693	2.3%
2,000,000	82,630	600,000	32,094	50,536	2.5%
2,500,000	100,177	750,000	36,444	63,733	2.5%

Don't get too hung up on the drop in percentages. Focus on the overall hard dollar amount. Notice the sweet spot at \$100,000 to \$150,000 (yes, it dips at \$300k due to Social Security limits). Also consider that if you run self-employed health insurance through the business (and you should), savings jumps up even more. Why? Check out our Taxpayer's Comprehensive Guide to LLCs and S Corps which expands on this concept-

[S Corp Book and Tax Savings](#)

Bottom line savings is about 8-10% of your net business income after expenses. So, if you make \$100,000 after expenses you'll save about \$8,000 in overall taxes, and they are all self-employment taxes. Self-employment taxes = Social Security / Medicare taxes = payroll taxes. All the same thing (in general). There is a cost to being an S corporation of course- all that glitters is only partial gold. See below for our S Corp "all in" packages aptly named Aspen, Vail, Breckenridge and Keystone. Yup, we're from Colorado!

Still not sure or not convinced? No problem... please check out Line 57 on your Form 1040 tax return. This number reflects the self-employment taxes paid on your business income. We want to reduce this by 60 to 65%.

Section 199A Pass Thru Tax Reform

Section 199A deduction also known as the Qualified Business Income deduction arises from the Tax Cuts & Jobs Act of 2017. This is a significant tax break for small business owners but there are rules and limits of course. We have written a short article which outlines what is considered a qualified business for the qualified business income deduction including the dreaded specified service trade definitions (which is easily summed up as “any trade or business where the principal asset is the reputation or skill” of the owner). Click on the button below for our article-

[Pass Thru Tax Reform](#)

S corporations remain a critical tax saving tool for two reasons. First, the usual self-employment tax savings remains intact for all business owners including specified service trades or businesses. Second, a business owner might need to pay W-2 wages to himself or herself to not be limited by income, and only corporations can pay W-2 wages to owners (in other words, an LLC cannot without an S Corp election). Read the article above for riveting information!

S Corp Election Money Trail

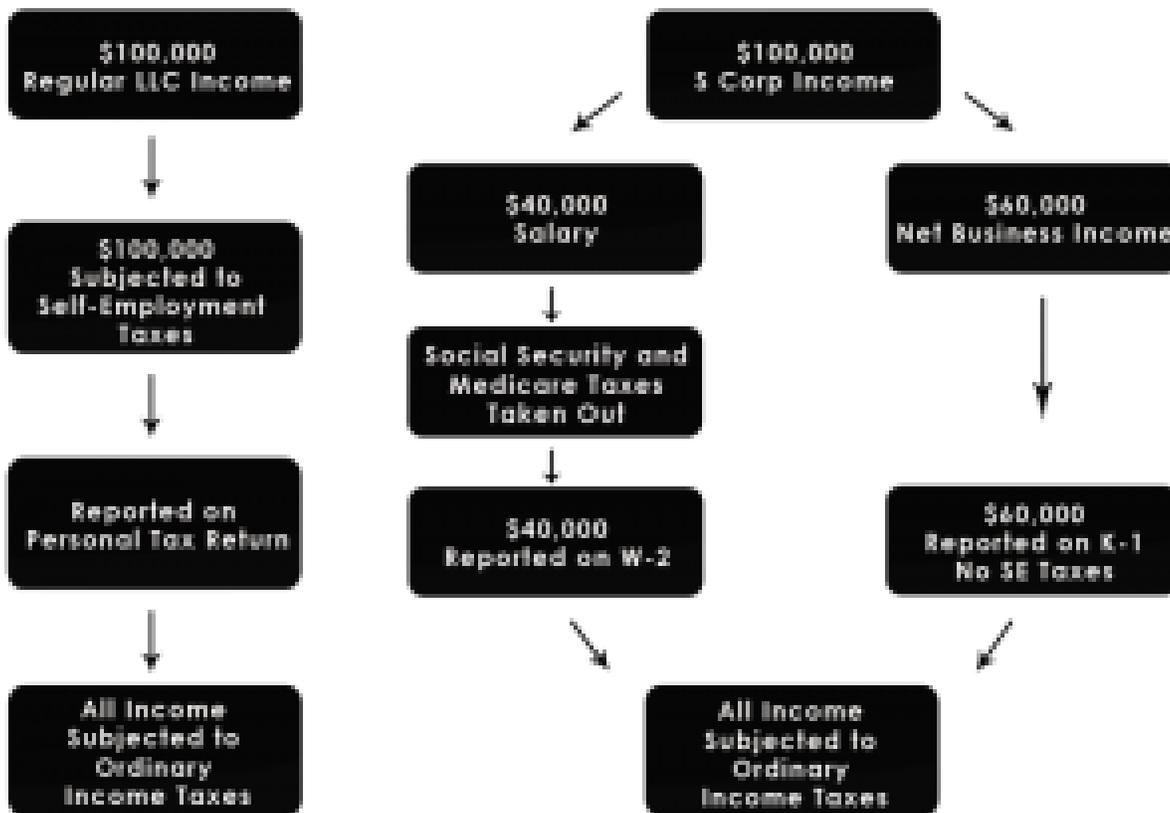
So, when your partnership, LLC or corporation is being taxed as an S Corp you are both an employee and a shareholder (think investor). As an employee, your income is subjected to all the usual taxes that you would see on a paystub- federal taxes, state taxes, Social Security taxes, Medicare taxes, unemployment and disability. However, as a shareholder or investor, you are simply getting a return on your investment much like a dividend (in S Corp world this is called a distribution).

A K-1 is a statement that each shareholder receives, and it is similar to a W-2 since it reports the income that each shareholder is responsible for from a taxation perspective. There are two types of K-1s for the purposes of our discussions- one is generated from a Form 1065 and the other is generated from a Form 1120S. A Form 1065 is also called a partnership tax return, and typically your K-1 will be subjected to self-employment taxes.

However, a K-1 generated from a Form 1120S (an underlying entity with the S Corp election) is reported on the shareholder’s personal tax return on Schedule E, Page 2. Schedule E is the form used for rental properties, royalties and other investment income including business income from an S corporation.

And when we say self-employment taxes, we are really talking about Social Security and Medicare taxes. From a sole proprietor perspective, they are self-employment taxes. From an employee perspective, they are Social Security and Medicare taxes (FICA). Same thing.

Let’s look at another visual in terms of how the money travels (picture time!)-



So an S Corp doesn't pay taxes per se since it is a pass-thru entity, and passes its tax obligation to the investors. There are some states that charge a franchise tax such as California and Texas, and other states have an S corporation tax that is egregious such as Tennessee, New Hampshire and New York City. Please read the full story on S corporation taxes and self employment taxes in our Taxpayer's Comprehensive Guide to LLCs and S Corps-

[S Corp Book and Tax Savings](#)

Business Consultation

How does all this S Corp election stuff work? Let's schedule a time to chat! The Watson CPA Group offers expert small business consultation in-person, by telephone or via Skype. We love to Skype- faces, inflections, all the good stuff for our long distance clients. Heck, even people in the same building seem to prefer a phone call or Skype.

Your Name (required)

Your Email (required)

Phone

State

Business Name

Your Message

Our fee is \$150 for 40 minutes. If we decide to press forward with an engagement, we will credit the \$150 towards future services like filing Form 2553. If you don't need convincing and already want our services such as business tax return preparation or S Corporation subscription, and you simply have some housekeeping questions, we answer those at no charge. Charging a consult fee to tell you how great we are is not cool.

Consultations are scheduled on **Mondays, Wednesdays and Thursdays**. Yes, we can accommodate other days and after-hours, but those are reluctantly agreed to. We will answer your

questions to determine three things-

- Do you need our help?
- Can the Watson CPA Group and its [support staff](#) help you?
- Can we work together as a collaborative partnership?

From there we can determine the best plan, and we will provide a quote for those services. You might be able to catch us online too-

Late S Corp Election, Oops

Form 2553 (the S Corp election form) must be filed with the IRS. It is typically due within 75 days of forming your business entity or the fiscal year start (such as Jan 1), however, there is relief for the late filing of Form 2553 and we can guide you through that. IRS Revenue Procedures 2003-43 and 2004-48 used to be the governing rules but the IRS has simplified it (imagine that!). We have an entire webpage dedicated to the late S Corp election. We can go back to January 2018! Check it out here-

[Late S Corp Election](#)



S Corp Package

The Watson CPA Group specializes in S corporations which have a small number of shareholders, and are often just a one-person show. Did you know that 95% of all S Corps have only one shareholder, and 99% of all S Corps have three or fewer shareholders? Because small business is a core competency for us, we have created an S corp package that includes the following (No, the S doesn't stand for stormtrooper)-

	A la Carte*	Aspen	Vail	Breck Keystone	
S Corp Reasonable Salary Calculation (sample report)	\$400	Yes	Yes	Yes	Yes
Section 199A QBID Tax Optimization (more info)	\$300	Yes	Yes	Yes	Yes
S Corp Payroll Filings and Deposits	\$1,200	Yes	Yes		
Annual Processing (W2s and other filings)	inc.	Yes	Yes		
S Corporation Tax Prep (Form 1120S), Section 199A Deduction	\$800 to \$1,200	Yes	Yes	Yes	Yes
Individual Tax Prep (Form 1040), One Owner	\$500 to \$700	Yes		Yes	
Estimated Tax Payments (done thru payroll or directly by us)	\$300	Yes	Yes	Yes	Yes

2018 Tax Planning, Mock Tax Returns (Tax Questionnaire)	\$300 to \$500	Yes	Yes	Yes	Yes
Unlimited Consultation and Periodic Business Reviews (PBR)	\$1,200	Yes	Yes	Yes	Yes
First Research Industry Reports (sample report)	\$150	Yes	Yes	Yes	Yes
Small Business Tax Deductions Optimization	inc.	Yes	Yes	Yes	Yes
IRS Audit Defense	NA	Yes		Yes	
	Annual Fee	\$2,940 \$2,640 \$2,460 \$2,160			
	Monthly Fee	\$245 \$220 \$205 \$180			

* A la Carte fee ranges are approximates. 90% of our clients fit into these fee ranges, but there are outliers. We have a handful of clients with over 30 rentals; their individual tax return is north of \$2,500.

Couple of other things to keep in mind- we make very little profits on payroll processing... we offer it as a convenience to our clients. One throat to choke with a single call can be reassuring but if you want to run your payroll, go for it! And... the benefit of the Watson CPA Group preparing both tax returns is that we slide things around depending on income limitations, phaseouts, alternative minimum tax (AMT), Section 199A deduction optimization, etc. Having our arms around both can yield some good tax savings!

Some more things to consider- Since only a partial year remains, our usual annual fee is pro-rated to not charge you for services you didn't use (like payroll and consultation). However, a large chunk of our annual fee is tax preparation which is typically a fixed amount of \$1,300 (both corporate and personal). Whether we onboard you in January, July or December, we have to prepare a full year tax return. This increases the monthly fee for the remaining months of 2018 but the monthly fee will later decrease in January of 2019 to reflect the amounts above. Yeah, we make it sound like 2019 is just around the corner.

No BS



We are not salespeople. We are not putting lipstick on a pig, and trying to convince you to love it, even if Tom Ford's Wild Ginger looks amazing. Our job remains being professionally detached, giving you information and letting you decide.

We see far too many crazy schemes and half-baked ideas from attorneys and wealth managers. In some cases, they are good ideas. In most cases, all the entities, layering and mixed ownership is only the **illusion of precision**. Just because you can complicate the crap out of your life doesn't mean you must.

Section 199A Deduction Optimization

Section 199A is a derivative of the recent Tax Cuts & Jobs Act of 2017. In a nutshell, business owners including rental property owners will enjoy a 20% deduction based on the qualified business income. There are limitations based on income, W-2 wages and depreciation. As a result, there is some optimization that is necessary for a small business owner to get the most from the Section 199A deduction. On one hand we want to reduce W-2 salaries to shareholders to minimize self-employment taxes. On

the other hand, we want to increase W-2 salaries so they do not limit the amount of Section 199A that is deducted. Read our full Section 199A Qualified Business Income article by clicking on the button below-

[Pass Thru Tax Reform](#)

Our Business Expertise



As mentioned elsewhere we primarily focus on small business owners and their unique consultation and tax preparation needs. With 16 full-time consultation professionals including Certified Public Accountants and Certified Financial Planners on [our team](#), the Watson CPA Group consults on corporate structures, S corp elections (even late S corp elections back to January), tax strategies, business coaching, industry analysis, executive benefits, retirement planning including individual 401k plans, exit strategies, business valuations, income tax modeling and tax representation.

We also work with business law attorneys in California, Texas and Colorado for business owners who have additional needs such as buying or selling a business including employee stock ownership plans and partner buy-ins. We also coordinate with Polycomp and RPS to create age-based profit sharing plans and cash balance (defined benefit) plans. We can run point on whatever your business needs so the communication is effective and efficient.

The button below links to our Periodic Business Review (PBR) Agenda. We use this throughout the year as a checklist for our business clients. We can also use it for any type of business consultation. Here are some other buttons that you might be interested in as well.

[Periodic Business Review \(PBR\)](#)

[S Corp Questionnaire](#)

[Sample Biz Services Proposal](#)

[Business Tax Deductions](#)

Click the button below to schedule a 40 minute consultation. Our fee is \$150, but we credit that back to you if you decide to engage us for future services. Low risk, high- reward.

[Business Consultation](#)

How does all this work? Let's chat!

S Corp Election Checklist

So we showed you all the fees and such... but we need to put the horse back in front of the carriage. Let's go through a quick

checklist to ensure that we are not going down the wrong road. As Doc Brown in Back to the Future says, "Roads? Where we're going, we don't need roads." Well, in S Corp land we do-

1. Does your business earn over \$30,000 net income after expenses? **Say Yes.**
2. Are you located in New York City or Tennessee where S corporation tax rates are egregious and suck up all the federal tax savings? New Hampshire? **Say No.**
3. Do you have other W-2 income that exceeds or comes close to exceeding the Social Security limits of \$128,400 (2018)? **Say No.** If you say Yes, we need net business income to exceed \$200,000 in #1 above so that the Medicare savings exceeds the "lost" Social Security tax paid by the S Corp.
4. Is this a going concern? In other words, is the business going to continue to earn the same income or more each year? **Say Yes.**
5. Do you have an LLC or some other entity in place that can be elected to be taxed as an S Corp? **Say Yes.** If you say No, we have options just not elegant ones such as shelf corporations.
6. Do you have other partners besides a spouse... business partners, that is? **Say No.** If you say Yes, are you currently splitting income based on ownership percentages or some formula? If you say Formula, then we'll need to explore a [multi-entity arrangement](#).
7. Does your entity own any appreciating assets such as real estate? **So No.** We don't put appreciating assets into an S corporation. Holding companies own real estate and operating companies elect S Corp status. Chinese Wall.

Are you still here? Excellent news... read on! You can also complete a PDF version of the above questions, and send them to us for review-

[S Corp Questionnaire](#)

Common S Corp candidates and current clients for the Watson CPA Group are consultants, engineers, financial advisors, physicians, chiropractors, doctors, surgeons, anesthesiologists, nurse anesthetists, insurance agents, attorneys, photographers (the profitable ones), online retailers, FBA retailers, real estate agents, good old fashioned widget makers, among several others. We also have several medical groups and financial advisor teams. Yes, even those deemed to be specified service trades or businesses still benefit with Section 199A coupled with an S Corp election!

Self Employed 401k Plan

Now that you can save thousands of dollars in self employment taxes with an S Corp election, you should invest that wisely. The Watson CPA Group is a small business too, and we understand that any extra dollars usually get invested back into the growing company. Having said that, there are several small business retirement plans which include solo 401k plans, profit sharing plans, cash balance and defined benefits pensions.

For example, with a solo 401k plan piggybacked with a defined benefits pension, you could sock away over \$192,000 at age 50. All tax deferred if you like, which could yield a savings of over \$86,000 (assuming a 45% marginal tax rate with federal and state). Wow!

Note how we purposely did not mention SEP IRAs. These are old school and are usually designed to be crisis management tools (after the fact) rather than good planning tools. Read more about the various self employed retirement options, including retirement tax bombs and the difference between tax deferral and tax savings below-

Self Directed IRA
Retirement Tax Bomb

Self Directed IRA Problems
Tax Deferral Concerns

Please contact us today to get started on electing S-Corp status! All the cool kids are doing it- well, most, and we'll have to ask several questions to make sure the fit is right.