

What You Need To Know About S Corporations

BEFORE YOU MAKE THE SWITCH

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Hey, I'm Sara!

Chances are, you're reading this because you're wondering if an S corp is going to be your magical answer to paying less in taxes.

The answer is... (drumroll please) it depends!

An S corp can be a *powerful* tool to save on self-employment taxes, but depending on your earnings level and long-term goals, it may not be the right fit for your business.

This guide is not intended as financial advice. Please work with a qualified tax accountant to determine the best course of action for your business.

WHAT ACTUALLY IS AN S Corporation?

Contrary to population belief, an S corporation is *not* a different legal entity; it's an election you can make to change your business's *tax status*.

So, why bother changing your tax status?

The biggest pro is that you can minimize your income subject to that pesky 15.3% of self-employment tax. For S corp owners, compensation is broken down into two parts:

SALARY

A reasonable compensation amount that is paid via payroll and is subject to payroll + self-employment taxes.

DISTRIBUTIONS

Any additional profits left over after paying a reasonable salary can be taken as distributions (not subject to payroll or SE tax), which are taxed at your ordinary income rate.



HOW TO ELECT TO BE TAXED

As An S Corporation:

Meet Eligibility Requirements

In order to be taxed as an S corporation, your business must be a domestic corporation or an eligible entity, with 100 or fewer eligible shareholders and one class of stock. All shareholders will need to give consent to elect to be taxed as an S corporation.

File Form 2553 (new business)

For a new business, an S election filing must be made no later than 2 months and 15 days after the beginning of the business's tax year.

File Form 2553 (existing business)

For existing businesses, the S election can be made at any time during the preceding tax year, or on or before the 15th day of the third month of the taxable year for which the election is to be effective.

Obtain IRS Approval

If your S corporation tax status is approved, the IRS will send you a CP261 notice informing you of the start date of your S corporation. You'll receive a CP264 notice if your S corporation election was not approved. Once approved, your S corporation election will remain in effect until you revoke it or no longer meet the eligibility requirements.

What you'll need to file:

FORM 1120-S

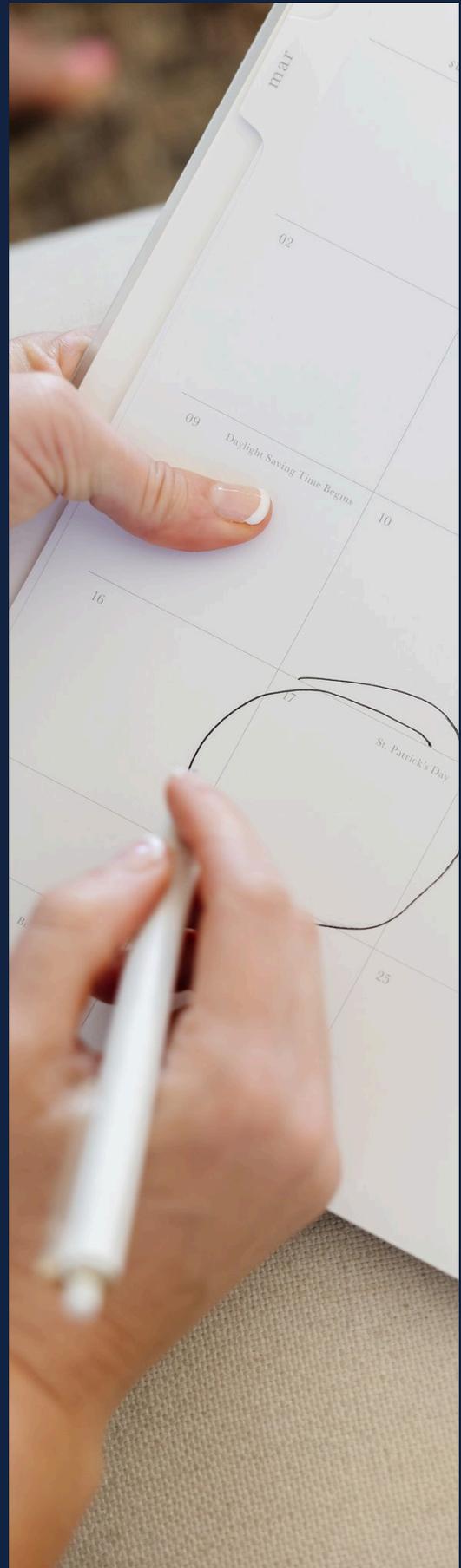
On an annual basis, you'll need to file your U.S. Income Tax Return for an S Corporation. Depending on your state, you may have additional state filing requirements.

SCHEDULE K-1S

You'll need to furnish a Schedule K-1 to each shareholder showing their share of the income, losses, deductions, and credits.

PAYROLL FILINGS

You'll also need to account for all state and federal payroll tax filings, including your quarterly Form 941, Form 940 (if subject to FUTA), and Forms W-2 + W-3.





What you need to know about paying yourself:

RUNNING PAYROLL

As an S corporation owner-employee, you'll need to determine a *reasonable salary* + pay yourself via payroll.

Here's what you'll want to consider when determining *how much* is reasonable compensation:

- What would an employee in a similar role within your industry be paid?
- What is the time commitment, level of complexity, and skill required for this job?

The last thing the IRS wants is for you to pay yourself an unreasonably low salary (*and not pay them self-employment + payroll taxes*) and take all of your earnings in distributions.

What you need to know about paying yourself:

DISTRIBUTIONS

Once you've paid yourself a reasonable salary, you'll ideally have profits left over (*if you don't, an S corporation might not be the move*).

That remaining money can be paid to the shareholders as **distributions**.

Distributions aren't subject to payroll tax or self-employment tax.

What's the catch with distributions?

Distributions must be made in accordance with ownership percentages. For example, if you're the sole owner, you can take 100% of the distributions. You'll also need to track your basis as distributions in excess of your basis can be taxable.



Ask Your Accountant

+ When is an S corporation election right for my business?

This question can truly only be answered by performing a cost-benefit analysis based on your business's earnings, a reasonable salary, and additional tax considerations. Please consult with your tax accountant to ensure the election is worth the potential costs and administrative requirements.

+ How will this affect my Qualified Business Income deduction?

Making an S election can affect your 199a deduction, so you'll want to understand your potential QBI implications.

+ What do I need to know about how my state treats S corporations?

Some states will recognize or treat S corporations and their income differently, or may have additional taxes.

Ask Your Accountant

+ What is a reasonable compensation amount to pay myself?

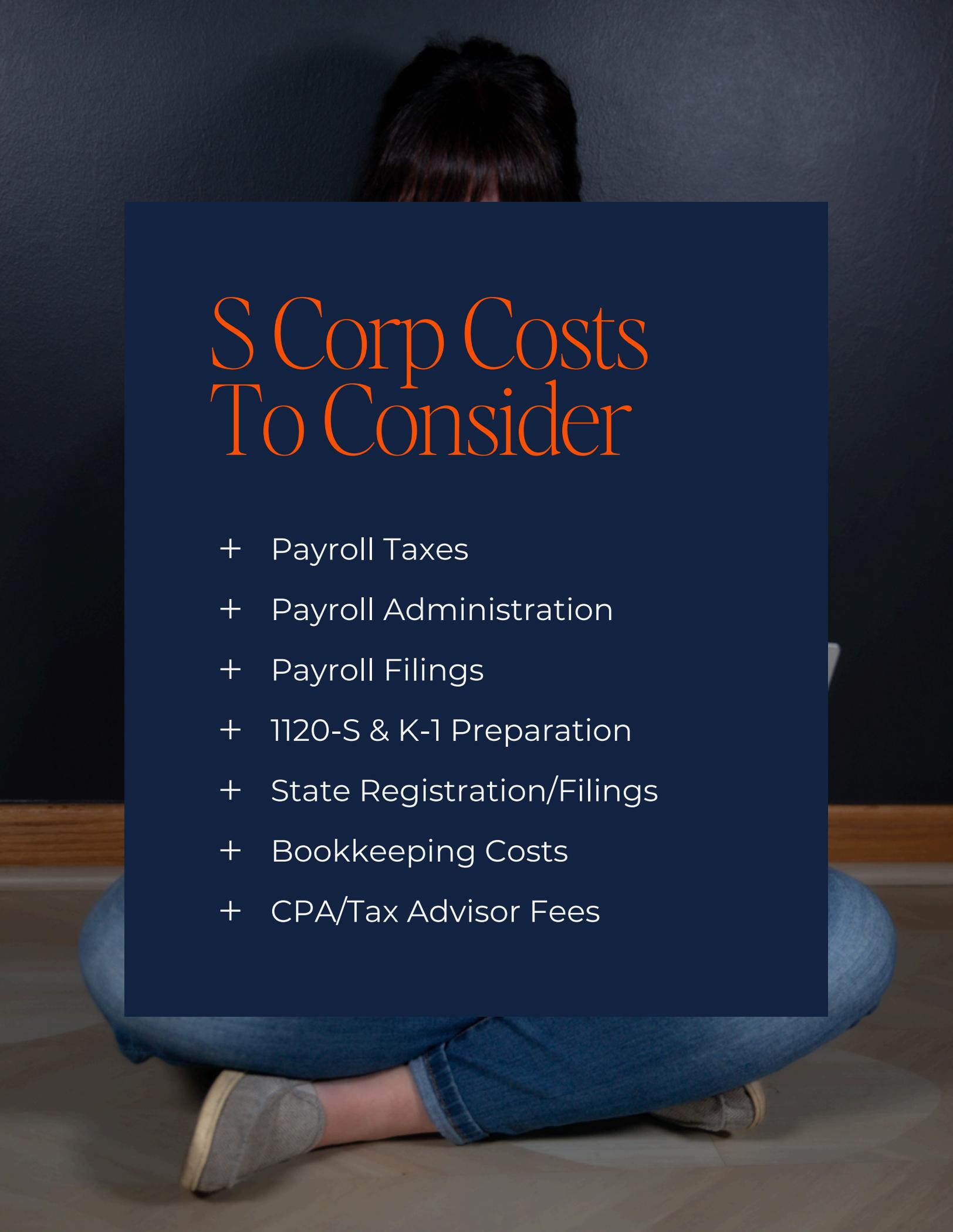
Your accountant may be able to run a reasonable compensation report or help you determine what other employees in similar roles are being paid. A great reference point is Salary.com!

+ Can you help me create an accountable plan?

An accountable plan is a formal arrangement that allows an S corporation to reimburse employees for business expenses without including those payments as taxable wages.

+ How will my tax preparation costs be affected?

Find out the costs associated with filing an S election, your annual 1120-S filing, K-1 preparation, and any additional compliance costs.



S Corp Costs To Consider

- + Payroll Taxes
- + Payroll Administration
- + Payroll Filings
- + 1120-S & K-1 Preparation
- + State Registration/Filings
- + Bookkeeping Costs
- + CPA/Tax Advisor Fees



Let's Connect!

I'm passionate about helping small business owners understand their numbers through monthly bookkeeping.

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