

**Tax Savings: S-Corp vs. LLC**

**Basic Guidance (see more detailed Q & A's below):**

**Bottom line → Right now – S-Corps do not pay FICA taxes on dividends/distributions. LLC's do.**

**Pro → Save 15% on taxes now on the dividends/distribution.**

**Con → Lowers your social security base and future benefit payment as you are not paying into the system.**

*Note 1: All calculations below use 2014 rates. To use this for 2015 and beyond the rates will need to be adjusted.*

*Note 2: If flexible equity distributions are important then refer to the section below called Ownership/Shareholder Considerations*

*Note 3: All this information is subject to interpretation and does not constitute professional tax advice. Consult with your professional CPA or tax preparer for more details.*

*Note 4: This exploratory tool was developed in collaboration with Steve Stokes of Stokes, Visca & CO., LLP - CPA's at (585) 427-0850*

**Input Cells**

**Calculated Cells**

**\$ 100,000 Total Income**

<b>S-Corp</b>	
\$ 100,000	Total Income
60%	Salary - W-2
\$ 60,000	Salary
\$ 40,000	Dividends

<b>LLC</b>	
\$ 100,000	Total Income
100%	Salary - W-2
\$ 100,000	Salary
\$ -	Dividends

\$ 7,440	Social Security Tax	12.4%	On Salary
\$ 1,740	Medicare Tax	2.9%	On Salary
\$ 12,000	Federal Tax	20%	On Salary
\$ 4,200	State Tax	7%	On Salary
<b>\$ 25,380</b>	<b>Total Tax</b>	<b>NA</b>	<b>On Salary</b>
NA	<b>Tax Rate On Salary</b>	<b>42%</b>	<b>On Salary</b>

\$ 12,400	Social Security Tax	12.4%	On Salary
\$ 2,900	Medicare Tax	2.9%	On Salary
\$ 20,000	Federal Tax	<b>20%</b>	On Salary
\$ 7,000	State Tax	<b>7%</b>	On Salary
<b>\$ 42,300</b>	<b>Total Tax</b>	<b>NA</b>	<b>On Salary</b>
NA	<b>Total Tax Rate</b>	<b>42%</b>	<b>On Salary</b>

**Check**  
**\$ 4,960**

\$ -	Social Security Tax	0%	On Dividends
<b>\$ 1,160</b>	<b>Medicare Tax</b>	<b>2.9%</b>	<b>On Dividends</b>
\$ 8,000	Federal Tax	20%	On Dividends
\$ 2,800	State Tax	7%	On Dividends
<b>\$ 11,960</b>	<b>Total Tax</b>	<b>NA</b>	<b>On Dividends</b>
NA	<b>Tax Rate On Dividends</b>	<b>30%</b>	<b>On Dividends</b>

NA	Social Security Tax	NA	On Dividends
NA	Medicare Tax	NA	On Dividends
NA	Federal Tax	NA	On Dividends
NA	State Tax	NA	On Dividends
NA	Total Tax	NA	On Dividends
NA	Total Tax Rate	NA	On Dividends

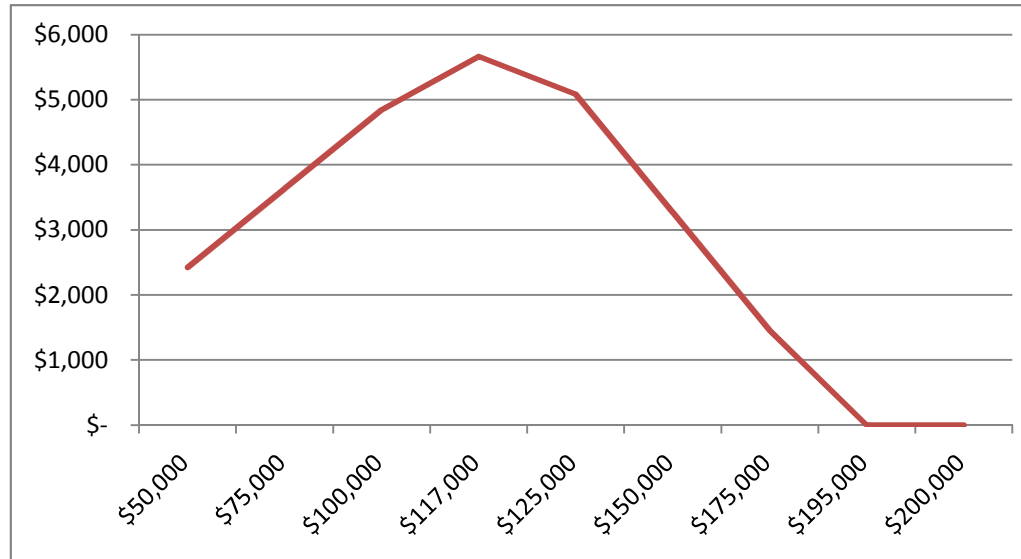
**TOTAL TAX RATE** 37%  
**TOTAL TAX PAID** \$ 37,340

**TOTAL TAX RATE** 42%  
**TOTAL TAX PAID** \$ 42,300

**Bottom Line: \$ 4,960 Less Tax with S-Corp than LLC**

**Bottom Line Summary**

<b>Total Income</b>	\$ 50,000	\$ 75,000	\$ 100,000	<b>\$ 117,000</b>	\$ 125,000	\$ 150,000	\$ 175,000	\$ 195,000	\$ 200,000
<b>Less Tax @60% Salary</b>	\$ 2,420	\$ 3,630	\$ 4,840	<b>\$ 5,663</b>	\$ 5,082	\$ 3,267	\$ 1,452	\$ -	\$ -
<b>Percentage of Total Income</b>	5%	5%	5%	5%	4%	2%	1%	0%	0%



Q1: Why does the savings drop-off after \$117,000?

A: As Total Income increases beyond \$117,000 at 60% Salary and 40% Dividends the Salary part increases until at a Total Income of \$195,000 the 60% Salary is \$117,000 and there is no savings.

Q2: What is FICA?

A: [THE FEDERAL INSURANCE CONTRIBUTIONS ACT TAX: http://en.wikipedia.org/wiki/Federal\\_Insurance\\_Contributions\\_Act\\_tax](http://en.wikipedia.org/wiki/Federal_Insurance_Contributions_Act_tax)

Q3: What does it consist of?

A: FICA INCLUDES BOTH SOCIAL SECURITY AND MEDICARE.

Q4: What is the tax rate for each?

A: THE TOTAL TAX RATE IS 15.3%, WITH 12.4% FOR SOCIAL SECURITY AND 2.9% FOR MEDICARE.

Q5: Is there a cap on taxable income.

A: SOCIAL SECURITY TAXABLE INCOME IS CAPPED AT \$117,000 for 2014. THERE IS NO CAP FOR MEDICARE.

Q6: When analyzing whether to form an S-Corp or LLC, does the nature of the income (active vs. passive) matter?

A: NO.

Q7: Does this have an impact on whether you can pay yourself a salary as an employee, versus taking a dividend and not paying yourself a salary, or is this question answered purely by the entity type?

A: ENTITY TYPE.

Q8: Consulting would fall into the "active" category, meaning that you actively spend your time in the business, providing services to clients. "Passive" may refer to rental properties, in which you collect rents, versus trading time for money, as you do in consulting. Does it matter which type of activity is performed in choosing an entity?

A:

- RENTAL ACTIVITY IS CONSIDERED PASSIVE AND IS REPORTED ON A SCHEDULE E, SO IT IS NOT SUBJECT TO SOCIAL SECURITY TAXES.
- IN THE CASE OF THE LLC ACTIVE INCOME IS REPORTED ON A SCHEDULE C, OR A PARTNERSHIP RETURN, AND IS SUBJECT TO SOCIAL SECURITY TAXES.
- IN SUMMARY, ALL LLC EARNINGS ARE SUBJECT TO SOCIAL SECURITY TAXES, UNLESS IT COMES FROM PASSIVE ACTIVITIES – RENTAL.
- S-CORP DIVIDENDS ARE NOT SUBJECT TO SOCIAL SECURITY TAXES. ONLY THE WAGES TAKEN FROM THE S-CORP ARE.

Q9: Am I correct that rentals are considered passive income (even though it isn't) and we are forced to be in an LLC and pay full boat FICA (Social Security and Medicare)?

A: NO NOT CORRECT. RENTALS CAN BE IN AN S-CORP OR C-CORP OR LLC OR NOT IN ANY CORPORATE ENTITY.

Q10: In other words even if I wanted to I could not hold rental properties in an S-Corp and take some of the income as dividends?

A: YES YOU COULD HOLD RENTALS IN AN S-CORP. HOWEVER, SINCE RENTAL INCOME IS PASSIVE YOU CAN ALSO HOLD RENTALS IN AN LLC AND NOT PAY SOCIAL SECURITY TAXES. THAT IS WHY LLC'S ARE POPULAR FOR RENTALS. RENTAL INCOME IS NOT SUBJECT TO SOCIAL SECURITY TAXES AS IT IS CONSIDERED A PASSIVE ACTIVITY.

Q11: Another question would be does the fact that the entity is a single member LLC (vs. multiple members) make a difference as to how social security taxes would be treated?

A: NO.

Q12: Does it change anything if you had another owner where the entity now had to file a separate tax return and issue the owners K-1s?

A: NO, DOES NOT MATTER, ALL LLC EARNINGS PASS THROUGH TO MEMBERS AND ARE SUBJECT TO SOCIAL SECURITY TAXES, UNLESS THE EARNINGS COME FROM RENTAL.

Q13: The one issue that is still not clear to me in the S vs. LLC debate is how social security taxes (FICA/Medicare) are affected for single member LLCs or sole owner S corps.

A: NO DIFFERENCE

Q14: You used a 60/40 split in your example, yet some say you have to pay yourself a market rate for your services and that's 100%. What guidance can you provide about determining the split between Salary versus Dividends?

A: HARD TO SAY VERY SUBJECTIVE. IT REALLY DEPENDS ON THE SIZE OF THE BUSINESS AND THE PROFITABILITY. WE USE 60/40 AS IT HAS BEEN OUR EXPERIENCE THAT AS LONG AS THE IRS SEES AT LEAST 60% IN SALARY THEY ARE USUALLY OK WITH THE OFFICER'S/OWNERS COMP. HOWEVER, THIS DOES NOT MEAN THE IRS COULD NOT ARGUE FOR 100%. VERY SUBJECTIVE. ALSO WE HAVE HEARD THE IRS AND CONGRESS MAY BE CHANGING THE TAX LAW SO THAT ALL S-CORP EARNINGS WILL BE SUBJECT TO SOCIAL SECURITY TAXES LIKE LLC'S. HAS NOT HAPPENED YET BUT CHANGE MAY BE COMING.

Q15: Is part of this related to risk tolerance?

A: YES SOMEWHAT

Q16: If the IRS came back on me and claimed I needed to use a difference split in retrospect that would not be considered "tax evasion". Correct?

A: YES CORRECT. THE INCOME IS BEING REPORTED SO THERE IS NO TAX EVASION. TAX EVASION IS WHEN YOU FRAUDUENTLY HIDE OR DO NOT REPORT INCOME OR MAKE UP "PHONY" EXPENSES.

Q17: As I understand it "Tax Avoidance" (the name so the game) is legal, whereas "Tax Evasion" is not.

A: CORRECT.

### **Summary:**

1 – S-CORPS ARE BETTER FOR TAX PLANNING AS YOU CAN REDUCE TAXES BY PAYING LESS SOCIAL SECURITY TAXES AS S CORP DISTRIBUTIONS ARE NOT SUBJECT TO SOCIAL SECURITY TAXES. SO IF YOU TAKE OUT OF \$ 100,000 - \$ 60,000 AS SALARY AND \$ 40,000 AS DIVIDENDS YOU WILL SAVE APPROXIMATELY \$ 6,000 IN TAXES (15% TIMES \$ 40,000). HOWEVER, PAYING LESS SOCIAL SECURITY TAXES ALSO WILL NEGATIVELY IMPACT YOUR SOCIAL SECURITY BENEFIT WHEN YOU RETIRE.

2 – IN THE CASE OF PASSIVE INCOME – RENTALS THERE ARE NO SOCIAL SECURITY TAXES SO AN LLC WILL BE TAXED THE SAME AS AN S-CORP. SO LLC'S ARE FINE FOR RENTAL PROPERTIES

3 – IF YOU WANT TO MAXIMIZE YOUR SOCIAL SECURITY BENEFIT WHEN YOU RETIRE PAY YOURSELF ALL/ MAX SALARY (I.E. 117,000).

### **Ownership/Shareholder Considerations:**

S-Corporations limit the number of shareholders to 75 and only allows for common stock as equity, not preferred stock.

Therefore all shareholders in an S-Corp are treated equally and must share in distributions in accordance with their shareholder percentage.

You can have voting and non-voting stock in an S-Corp.

LLCs allow for much more flexibility in splitting profits/cash flows of the entity.

In other words you can discriminate and do not have to share profits equally or in accordance with shareholder percentage in an LLC.

The decision tree allowed by the above spreadsheet is applicable if flexible equity distributions are NOT important.

This may be the case for "everyman" type individuals trying to make their way through the new world order that just "isn't Kansas anymore, is it Toto..."

Don't let the government screw your family any more than they already are. This is one way to fight back. There are others...