PAY WAGES AS AN S-CORPORATION TO AVOID IRS PAYROLL AUDIT
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August, 2008

1. The IRS has launched a campaign against S Corporations that do not pay payroll tax for owner-employee distributions. See IR-2005-76 dated July 25, 2005.

2. S-corps can pay lower payroll taxes to employee/owners than LLCs.

A single-member LLC treated as a disregarded entity reports its income and deductions on a Schedule C tax form. This tax accounting means that the LLC owner pays self-employment taxes of roughly 15% on the first $100,000 of profits and roughly 3% therefore, on all of the LLC's profits.

In comparison, an S corporation is a passive business entity that does not have to file a tax return and net income is reported on a K-1 issued to the shareholder. Self-employment tax deductions are only paid on the amount of profit called "wages." This means that the S corporation can control the level of payroll deductions by apportioning compensation to employee/shareholders as "wages" and as net income.

To show you how powerful this self-employment tax saving gambit can be, suppose that an LLC makes $100,000 in profits. If the LLC is treated as a sole proprietorship, the self-employment tax bill roughly costs $15,000 each year.

If the business entity is an S corporation, and the owner's wage amount is set at $50,000, the self-employment tax bill roughly costs $7,500 each year. **Accordingly, an S corporation saves the owner roughly $7,500 annually in employment taxes.**

TO MINIMIZE TAX CONSEQUENCES AND AUDIT POTENTIAL IF YOU ARE A SINGLE SHAREHOLDER S-CORP.

1. Set a **reasonable** wage for yourself and pay yourself a salary once a month. If your gross income is $500,000 a year, then pay yourself at least 20% or $100,000 divided by 12, or $8,333 per month subject to payroll deductions.

2. Set up an account with a Payroll Service such as Primepay who will determine the appropriate deductions and file the paperwork for you. You can keep control of your own bank account and pay yourself. Just make sure to report your monthly wages to the service so they can timely file with the IRS.

3. The remainder of the S-corp income is reported on a K-1 report to the shareholder and passively flows through to the shareholder as the taxable entity. The S-corp does not have to file a separate corporate tax return.