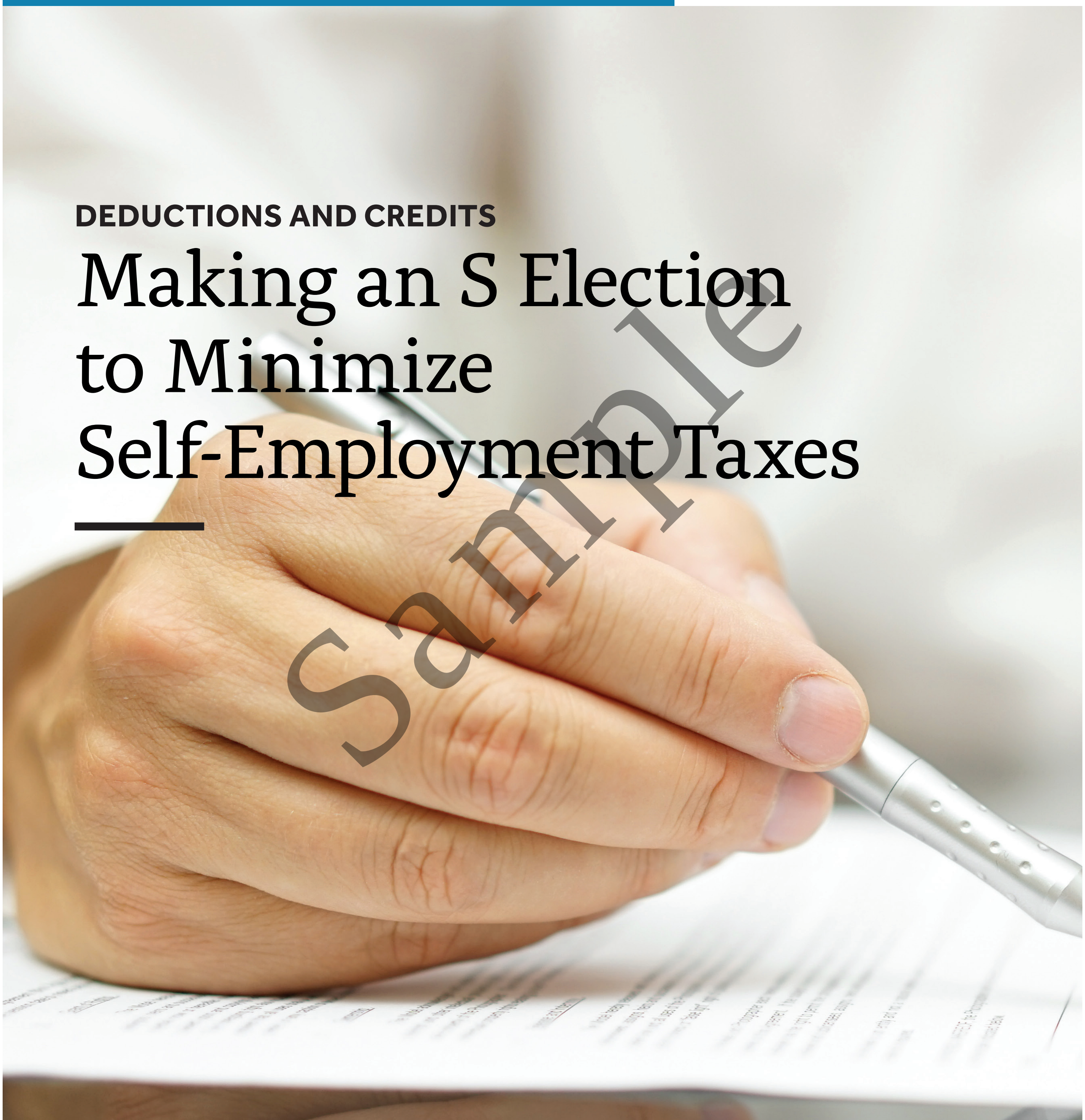
Navigating
Income Tax



DEDUCTIONS AND CREDITS

Making an S Election to Minimize Self-Employment Taxes

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Employment Taxes – In General

Owners of entities taxed as sole proprietorships or partnerships are generally responsible for self-employment taxes, i.e., Federal Insurance Contributions Act (FICA) taxes and Medicare taxes, on their share of the net business income as well as any guaranteed payments received from the business. The self-employment tax rate is 15.3% which consists of a 12.4% tax for FICA (applied to income up to $147,000 in 2022) and 2.9% tax for Medicare (applied to all income). As a self-employed individual, the owner is considered both the employer and the employee, which makes the entire self-employment tax burden theirs. This is mitigated somewhat because the owner receives an income tax deduction for one-half of the self-employment taxes paid. In addition, individuals with income in excess of $200,000 ($250,000 for married taxpayers) are subject to an additional 0.9% Medicare surtax on the entire amount of income in excess of this threshold.

In contrast, owners of S corporations are responsible for payroll taxes only on the wages paid to them by the business, whereas the net business income from the S corporation is not subject to payroll (i.e., self-employment) taxes.

Self-Employment Tax Analysis

The following estimates the annual tax savings that could be achieved by making an S election, assuming:

- Total income from your business (sole proprietorship) is $1,000,000;
- An estimation of the FICA and Medicare taxes you pay on your total income is $47,228;
- A reasonable salary for someone in your line of work is $100,000 annually.

Consequently, by making an S election and establishing a reasonable salary of $100,000, you could realize annual self-employment tax savings of approximately $31,928. This is only an estimate and should not be relied upon as it relates to your actual return; accordingly, please consult your own professional tax advisor.

In determining a "reasonable" salary, you should consult with accountant or local counsel. The following are factors to be considered when defining what is a reasonable salary:

- The volume of business handled;
- The character and degree of responsibility;
- The complexity of the business;
- The amount of time required to run the company;
- The general cost of living in the locality;
- The abilities and achievements of similar employees performing the services;
- A comparison of the employee's salary to the gross and net income of the company;
- Dividends paid to shareholders if the business is a corporation;
- The company's salary policy;
- The salary history of each employee; and
- The duties performed by the employee.

If the IRS determines that the salary is unreasonably low, they may recharacterize all or part of the corporate distributions as wages and assess an additional payroll tax liability.