



Subject: “S” CORPORATION PAYROLL TAX SAVINGS

Owners/Operators of “S” corporations, “wear 2 hats”, that of a shareholder and also as an employee who works for the corporation. The shareholder “hat” desires dividend distributions from corporate profits, whereas the employee “hat” deserves wages for services rendered.

KEY POINT – Dividends paid to “S” corporation shareholders are NOT subject to FICA or Medicare taxes. Wages paid to owner/employees of the “S” corporation are subject to FICA and Medicare taxes at a combined rate of 15.3% of the first \$106,800 in annual W-2 wages, plus 2.9% on wages above that amount.

THE IRS SAYS – Wages paid to employee-owners of “S” corporations must be “reasonable” in amount. “Reasonable wages” depends on the value of the owners’ services, complexity of the work, hours worked, and numerous other factors.

POTENTIAL TAX SAVINGS

Example – A small business owner generates \$100,000 per year in profit. If the small business owner is unincorporated or takes all the business net income in wages, the FICA/Medicare tax tab is \$15,300 – Every Year!

The same small business owner operates as a “S” corporation, takes \$50,000 in salary as “reasonable compensation”, and also receives \$50,000 in dividend distributions from profits. This structure generates \$7,650 in annual FICA and Medicare taxes – **TAX SAVINGS OF \$7,650 EVERY YEAR.**

Business owners who can benefit from payroll tax savings in a “S” corporation structure often have one or more of the following characteristics:

- ✓ The business employs people other than the owner;
- ✓ The business requires capital investment for equipment, inventory, and working capital;
- ✓ The business generates profits from reputation and “goodwill”; and

- ✓ The business is one that generally can be sold to another person. It does not revolve entirely around the technical skills of the owner.

CONCLUSION – Setting “S” corporation owners’ salaries at “reasonable amounts” can save substantial FICA/Medicare taxes every year. However, you also must consider other factors, including the impact of decreased wages on the amounts you can contribute to tax-deductible retirement plans.

AccuPay has many “S” corporation clients who are saving payroll taxes by “setting” owner’s compensation at “reasonable” amounts. You should talk with your CPA, tax advisor, or one of AccuPay’s “CPA/advisors” to learn more about this complex tax planning strategy.

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