

# Your S Corporation: A User-Friendly Guide

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## A. Setting Up Your S Corporation

### Electing S Corporation Status

- **Form 2553 Deadline:** To elect S Corporation status for a specific tax year, you must file **Form 2553** by **March 15th** of that year.
  - **Example:** To be taxed as an S Corporation for **2024**, file Form 2553 by **March 15, 2024**.
  - Missing the deadline means the election applies to the following tax year.

### New Tax Filing Requirements

- **Separate Tax Return:** As an S Corporation, you'll need to file **Form 1120S** annually.
  - **Due Date:** This return is due on **March 15th** each year, not April 15th.
  - **Complexity:** Preparing Form 1120S can be complicated; professional assistance is often recommended.

### Understanding S Corporation Status

- **Tax Designation, Not Legal Entity:** An S Corporation is a tax status you elect for your existing LLC or corporation.
  - You **own an LLC or corporation** that is **taxed as an S Corporation**.
  - **Note:** You don't "own an S Corporation"—you own a company that's elected S Corporation tax treatment.

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## B. Operating Your S Corporation

### Paying Yourself: W-2 Salary

- **Requirement:** You must pay yourself a reasonable salary through payroll, reported on a **W-2**.
  - **Register for Payroll Taxes:** Enroll with your state's agencies to handle unemployment tax and income tax withholdings.
  - **Federal Payroll Taxes:** Submit federal payroll taxes quarterly or monthly, similar to any employer.

## Determining Reasonable Compensation

- **Definition:** "Reasonable compensation" is what you would pay someone else to perform your role.
  - **Benchmarking:** Research average salaries for your position in your area.
    - **Example:**
      - *Landscaping Manager:* If the average salary is **\$55,000**, that's your benchmark.
      - *Dentist:* If the average salary is **\$100,000**, aim for that amount.
  - **Typical Minimum:** Often at least **\$50,000**, but it varies by industry and role.

## Distributions vs. Salary

- **Two Ways to Pay Yourself:**
  1. **W-2 Salary:** Subject to payroll taxes.
  2. **Owner Distributions:** Profits withdrawn from the business, **not** subject to self-employment taxes.
- **Tax Advantage:** Owner distributions avoid the 15% self-employment tax that applies to sole proprietors and LLCs.
- **Compliance Warning:** Paying yourself too low a salary can lead to IRS penalties.
  - The IRS may reclassify distributions as wages, resulting in back taxes and penalties.

## Accountable Plan for Expenses

- **Purpose:** To ensure you receive tax deductions for business-related personal expenses.
- **How It Works:**
  - **Reimbursements:** You pay for expenses personally and the business reimburses you.
  - **Common Expenses:**
    - **Cell Phone:**
      - Determine business-use percentage.
      - *Example:* \$100 bill with 50% business use = \$50 reimbursement.
    - **Mileage:**
      - Track business miles and reimburse at the standard rate (\$0.655 per mile for 2023).
      - *Example:* 1,000 miles x \$0.655 = \$655 reimbursement.
    - **Home Office:**
      - Use the simplified method: \$5 per square foot, up to 300 sq ft.
      - *Example:* 200 sq ft office x \$5 = \$1,000 reimbursement.
  - **Record-Keeping:** Document all reimbursements and categorize them appropriately.

## Impact on Tax Deductions and Retirement Contributions

- **Qualified Business Income Deduction (QBID):**
  - **Limitation:** QBID may be reduced if your W-2 wages are too low.

- **Example:**
  - Business income: \$300,000
  - W-2 wages: \$40,000
  - Expected QBID: 20% of \$300,000 = \$60,000
  - Actual QBID limited to 50% of W-2 wages: 50% x \$40,000 = \$20,000
  - **Result:** Missed out on \$40,000 in deductions.
- **Retirement Contributions:**
  - **Solo 401(k) and SEP IRA:**
    - Employer contributions are based on your W-2 wages.
    - Lower wages mean lower potential contributions.

## Key Operational Guidelines

- **Maintain Accurate Books and Records:** Essential for compliance and maximizing deductions.
- **Separate Personal and Business Expenses:** Avoid mixing to prevent complications.
- **Ensure Reasonable Compensation:** Align your salary with industry standards.
- **Enjoy Tax Savings:** Proper management leads to significant benefits.

## Considerations for Multiple Owners

- **W-2 Salaries for All:** Each owner working in the business must receive a reasonable salary.
- **Equitable Contributions and Distributions:**
  - **Requirement:** Must be proportional to ownership percentages.
  - **Example:**
    - In a 50/50 partnership, if one owner contributes or withdraws \$10,000, the other must do the same.
- **Risk of Losing S Corporation Status:**
  - Non-compliance can result in penalties or loss of S Corporation benefits.

## C. Additional Considerations

### Property Ownership

- **Avoid Holding Appreciating Assets:**
  - Do **not** hold real estate or assets that increase in value within your S Corporation.
- **Tax Implications:**
  - Distributing appreciated property triggers taxable gains.
  - **Example:**
    - Property bought for \$500,000, now worth \$1,000,000.
    - Distributing it results in a \$500,000 taxable gain.
- **Alternative:**
  - Hold such assets in a separate LLC to avoid these issues.

## Asset Distributions

- **Depreciated Assets:**
  - Transferring assets like vehicles to personal use can trigger gains.
  - **Example:**
    - A fully depreciated truck now worth \$10,000.
    - Distribution results in a \$10,000 taxable gain.

## Compliance is Crucial

- **Accurate Record-Keeping:** Protects against audits and penalties.
  - **Adherence to Rules:** Essential for maintaining S Corporation status.
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## D. Is an S Corporation Right for You?

### Factors to Consider

1. **Profit Levels:**
  - **Threshold:** Business profits should exceed your reasonable salary.
  - **Example:**
    - If your salary is \$60,000, aim for profits above \$70,000.
  - **Reason:** To justify the additional costs and complexities.
2. **Ownership Structure:**
  - **Single vs. Multiple Owners:**
    - S Corporations can be less flexible for multiple owners.
  - **Special Allocations:**
    - Partnerships allow for flexible income and deduction allocations.
    - S Corporations require strict proportional distributions.
3. **Compliance Requirements:**
  - **Additional Tax Filings:**
    - File Form 1120S by March 15th.
    - Set up and manage payroll systems.
  - **Enhanced Accounting Needs:**
    - Detailed record-keeping and adherence to specific tax rules.

## Conclusion

- **Not One-Size-Fits-All:** S Corporations offer benefits but aren't suitable for everyone.

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Please reach out with any follow-up questions! TKH Accounting Services. Website: [tkhaccountingservices.com](http://tkhaccountingservices.com)