Should I Switch from a Sole Proprietorship to an S-Corp?

This worksheet will guide you through the examples and allow you to run the numbers for your own situation. If you would like someone to talk you through this, the worksheet can be used in tandem with *episode 21, Why You Should Switch From a Sole Proprietorship to an S-Corp*.

LIABILITY PROTECTION

A corporate structure allows liability protection by keeping your business and personal assets separate. Any personal assets will be in your name, and any business assets will be in your corporate name. There are 3 basic options to consider. All three provide liability protection. Each has a different twist, mainly dealing with taxes, which is discussed below.

- **Limited Liability Company (LLC)**
  - Provides liability protection and has a pass-through taxation, as if you are a sole proprietor.
- **S-Corporation (Subchapter S-Corp)**
  - Provides liability protection and has a pass-through taxation but you become an employee of your business, which will require regular payroll and payroll taxes.
- **C-Corporation**
  - Provides liability protection and is its own entity, meaning the corporation has its own tax return, tax brackets, and is kind of like a person for simplicity.

TAXES

This happens to be one of the major reasons most highly profitable solopreneurs make the change. There are a few things to keep in mind such as having to set up payroll and payroll taxes that you will want to consult with your CPA on.

- **LLC**
  - The LLC does not change your current tax situation. The LLC provides the corporate veil but no tax benefits unless you combine with changing the way you file your taxes. In order to get the tax benefits of the corporation, you will need to have an LLC filing as an S-Corp.
- **S-Corp**
  - Provide S-Corp veil and tax benefits of a corporation. You will be able to take advantage of certain tax benefits but especially in how you pay yourself. You will pay yourself via payroll but have the ability to take distributions. More on that below.
- **C-Corp**
  - Provide S-Corp veil and is its own entity, meaning the corporation files its own return and pays its own taxes. You would be an employee of your corporation – same as the S-Corp – kind of like before you became a solopreneur.

ANALYZE YOUR SITUATION

- Income for the year (Example: $200k) = $______________________
- What you want to take home (Example: $100k) = $______________________
  - **Sole Proprietorship** you would pay taxes on the first $137,700 of income. 15.3% self-employment Taxes equaling approximately $21,000. The $200,000 net income would be subject to a 24% marginal tax bracket resulting in $48,000 in ordinary income taxes. total estimated taxes of around $69,000. If you were to qualify for a qualified business income tax deduction, you would have an estimated tax bill of $56,000.
  - What is Qualified Business Income?
    - The net income minus expenses from business operations.
    - Most businesses qualify for the qualified business deduction.
  - Your numbers are likely less if you made $200K
  - **LLC** - The same numbers hold true if you are just an LLC
  - **Under an LLC filing as an S-Corp or if you were to be organized as an S-Corp,** you could do the following:
    - Pay yourself a salary of $100,000 and leave the remaining $100,000 in your business for future use. I have a twist for you to take advantage of this even more and pay less taxes below.
    - The $100K salary will have payroll taxes – it will be 7.65% for your payroll taxes and then your company will need to match that same 7.65% - so you are technically not avoiding the self-employment tax – it is still being paid by you. You and your business will pay the combined payroll taxes of 15.3%, which is $15,300.
    - Since the S-Corp filing is a pass-through taxation entity, your $200,000 net income from the year in the business will be taxed at 24% equaling another $48,000 for the year.
    - Total estimated taxes would be around $63,000.
    - If you were to qualify for the qualified business income deduction then you would most likely pay around $50,000.
  - If you were to organize as a C-Corporation, which some people did, to take advantage of the tax changes when President Trump came into office, your situation would look like this:
    - Your payroll costs and expenses to your company are the same at $15,300.
    - Your C-Corporation would have its own tax return and would show $100,000 of profit in this example. The taxes due from the corporation would be an estimated $21,000. corporate tax rates on the federal level are 21%.
    - We would then need to bring your $100,000 salary into your personal tax return. That $100,000 income would put you in a 22% tax bracket, estimated to be another $22,000.
    - In total, the tax costs in this example are around $58,300.

SO THE QUICK RUNDOWN IS AS FOLLOWS:

- The Sole Proprietorship estimated tax bill is (Example: $56,000) $______________________
- The LLC/S-Corp Filing tax bill is (Example: $50,000) $______________________
- The C-Corp tax bill is (Example: $58,000) $______________________
- In practice, most solopreneurs will go with the LLC/S-Corp filing due to the simplicity of having the LLC/S-Corp option. You will want to seek advice from your legal and tax professional to get a better understanding of which option is better for you.

I PROMISED YOU A TWIST WITH THE LLC/S-CORP OPTION

- This is what a lot of my solopreneur clients do. They form an LLC and file as an S-Corp. They then pay themselves a market rate for their position. Let's use the example of a copywriter. The average copywriter salary in the country is just under $60,000. They pay themselves $60,000 in base salary and take distributions of another $40,000 to get to the $100,000 annual income. In the previous example the taxes work as follows:
    - $60,000 will trigger around $9,000 in payroll taxes due by the company and yourself.
    - The $60,000 salary will then flow to the tax return.
    - My solopreneurs then take the $40,000 as a distribution, avoiding the payroll taxes of 15.3%, saving $6,000.
    - The remaining $140,000 income will flow to the tax return resulting in ordinary income taxes on $200,000 of $48,000 - 24% tax bracket.
    - The estimated tax bill is $57,000. If you qualify for the qualified business income tax deduction, you would most likely pay $44,000, saving you around $13,000.
    - That is an estimated savings of $12,000 over staying as a sole-proprietor.
    - A few caveats for you:
        - I did not account for state income taxes, – so you will need to account for those if you are in a state that has a state income tax
        - You need to consult with a CPA to ensure you are getting the proper advice for your unique situation.
        - This also accounts for qualifying for the qualified business income tax deduction and is for illustrative purposes only.
        - The tax numbers in these examples are purposefully inflated for illustrative purposes. Please make sure to seek the advice of your tax professional.

In my opinion, it is very wise to consider switching from a Sole Proprietorship to an S-Corp. The liability protection and the tax savings are definitely worth the time and expense of changing the structure of your business. But as always I recommend consulting with your A-Team (Accountant, Attorney, and Advisor, Financial, that is) to make sure you have proper guidance for your unique situation.