How Does an S Corp Save You Money on Taxes?

First let's talk about the C Corp. The C Corporation has double taxation. First, the corporation itself pays corporate tax and then the Shareholders pay taxes again on the money they take out of the corporation.

The LLC and S Corp are both flow through entities. This means that there is no corporate level tax like the C Corporation. Therefore, the income (and expenses and taxes) flow through to the owners' personal tax returns.

The difference between an LLC and an S Corp is that all of the LLC's income is assessed a self-employment tax. At the time of this article (2012) the self-employment tax rate is 13.3%. Self-employment taxes are the taxes you pay for Social Security and Medicare. So, on 100% of the LLC income the owners would pay 13.3%. For simplicity's sake, let's say a single member LLC makes $100,000 in profits in 2012. The self-employment tax would be $13,300 (100,000 x 13.3%).

Now let's look at an S Corp. As an S Corp Shareholder you register yourself as an employee of the business. You are technically not self-employed but an employee of your corporation. You would pay yourself as salary, or wages, what someone in your industry typically makes or approximately 50% of the profits (this varies from business to business and even shareholder to shareholder so discuss this and all tax particulars with your accountant or CPA). The other 50% you would pay yourself as a distribution. This distribution would be taxed at whatever your personal income tax rate is but will not be assessed the self-employment tax.

So let's illustrate this. As in the situation above, an S Corp earning $100,000 in income would pay 6.65% in self-employment taxes or $6,650 as opposed to the $13,300 in taxes to an LLC.

$13,300 vs. $6,650 in self-employment taxes. Which would you rather pay?