

Abstract: Keeping up with the complexity of the Internal Revenue Code is challenging enough for employed individuals. But for owner-employees, the difficulty level is particularly high. This article explains how your business structure determines the rules you must abide by.

Owner-employees need to stay up to speed on employment taxes

Keeping up with the complexity of the Internal Revenue Code is challenging for an individual and even more so for a business owner. But, if you're someone who handles both roles — an owner-employee — the difficulty level is particularly high. Nonetheless, it's important to stay up to speed on your specific obligations. As you're no doubt aware, much depends on the structure of your company.

Partnerships and LLCs

Generally, all trade or business income that flows through to you for income tax purposes is subject to self-employment taxes — even if the income isn't actually distributed to you. But such income may not be subject to self-employment taxes if you're a limited partner or member of a limited liability company whose ownership is equivalent to a limited partnership interest. Whether the additional 0.9% Medicare tax on earned income or the 3.8% net investment income tax (NIIT) applies also is complex to determine.

S corporations

Under an S corporation, only income you receive as salary is subject to employment taxes and, if applicable, the 0.9% Medicare tax. To reduce these taxes, you may want to keep your salary relatively — but not unreasonably — low and increase your distributions of company income (which generally isn't taxed at the corporate level or subject to the 0.9% Medicare tax or 3.8% NIIT).

C corporations

For C corporations, only income you receive as salary is subject to employment taxes. If applicable, the 0.9% Medicare tax may be due as well. Nevertheless, you may prefer to take more income as salary (which is deductible at the corporate level) as opposed to dividends (which aren't deductible at the corporate level, are taxed at the shareholder level and could be subject to the 3.8% NIIT) if the overall tax paid by both the corporation and you would be less. *Warning:* The IRS is cracking down on misclassification of corporate payments to shareholder-employees, so tread carefully.

Latest info

As this article went to press, tax law reform efforts were underway that may affect some of this article's content. Please contact our firm for the latest information.

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