

Paying Yourself as a Business Owner

Owning a business is challenging and hard work, so you'll want to compensate yourself appropriately. How you do that depends on the structure of your business.

SOLE PROPRIETORS (SOLE PROP)

As self-employed taxpayers, sole props aren't employees and aren't paid a salary. Therefore, when sole props need to take money from the business to pay themselves, they take draws.

Draws aren't taxed when they are taken. Instead, because a sole prop is a pass-through entity, all of the business's income is taxed on the owner's tax return using Schedule C. And self-employment tax will be calculated on Schedule SE.

PARTNERSHIPS

Like sole-props, partners in a partnership aren't employees. Profits from the business are distributed per the partnership agreement. These are called distributions or guaranteed payments.

Partnerships are another type of pass-through entity. Partners receive a Schedule K-1 that reports their share of the partnership's income. And partners pay income and self-employment tax on their individual tax returns similarly to sole props.

LIMITED LIABILITY COMPANIES (LLC)

If an LLC has only one owner, called a member, it's treated the same as a sole prop for tax purposes. If there are two or more members, it's treated as a partnership for tax purposes by default. Regardless of the number of members, any LLC can elect to be taxed as an S-corporation by filing Form 8832.

S-CORPORATIONS

As an S-corp owner, you are also an employee and will need to be paid a reasonable salary. What's considered reasonable depends on many factors including your industry, responsibilities and experience. This means the owner and the S-corp must submit payroll taxes. The owner reports these W-2 wages on their tax return, and the remaining business profit flows through to the owner's tax return via a Schedule K-1. However, since the IRS doesn't consider the owner of an S-corp to be self-employed, these earnings aren't subject to self-employment tax.

STATE TAXES

State income taxes vary so consult with your tax professional about how your company's profits will be taxed locally.



(516) 294-0400



(516) 938-0491



415 CROSSWAYS PARK DR.
SUITE C
WOODBURY, NY 11797

KVLSMCPA.COM

