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CKR Financial Services

monthly journal

HELPING OUR CLIENTS GET THE LEG UP OVER THE COMPETITION

We've been discussing business entities, what they are, how to set them up, and the tax implications of each. This month, we continue this topic with the

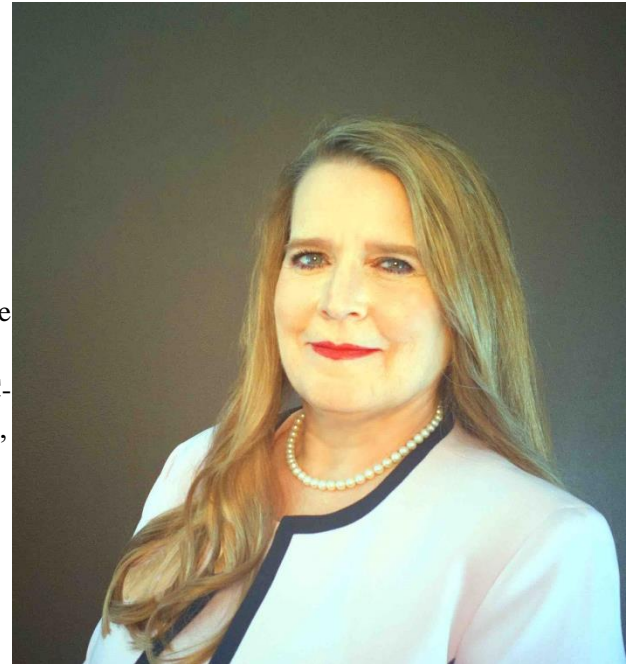
S-Corp

INTRO: Technically, the S-Corp is not a business entity so much as it is a tax election. Unlike LLC's or C-Corp's (which ARE entities), you cannot begin registration of a new company as an S-Corp. You must register the business as a Partnership, LLC or C-Corp and then file Form 2553 (Election by a Small Business Corporation) to request that the IRS tax you as an S-Corporation. It is called an "S-Corporation" because it has elected to be taxed under Subchapter S of the Internal Revenue Code, making it a "pass-through" entity for tax purposes. Why would you want to do this? If your LLC is making more than \$100,000.00 a year, all of that income is being taxed on the members' tax return along with a self-employment tax, which is an unfavorable tax bracket. By electing to be taxed as an S-Corp, your company can now pay you

wages that become an expense to the company, essentially pulling down the amount of taxable income to the company. At the same time, if your C-Corporation isn't meeting projections, making the taxable income smaller and getting rid of the "double-taxation" that can exist under the C-Corp umbrella can benefit your shareholders.

SETUP: To qualify for S-Corporation status, there are four IRS requirements. 1-the business must be incorporated domestically (within the US), 2-have only one class of stock, 3-not have more than 100 eligible shareholders. (Partnerships, Corporations, and nonresident aliens are not eligible to be shareholders for an S-Corp.), and 4-the company cannot be an ineligible corporation (i.e. certain financial institutions, insurance companies, and domestic international sales corporations).

PROS: 1-Asset protection. Much like the LLC, which we discussed last



month, an S-Corporation provides owners limited liability protection, which means the owners'/shareholders' personal assets are shielded from the claims of business creditors or litigation.

2-Pass-Through Taxation. S-Corp status can lower the personal income tax for business owners/shareholders by characterizing the money they receive from the corporation as salary or distributions. This often lowers their liability for self-employment tax. For C-Corps that opt to change, they no longer have to pay taxes at the entity level.

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APPRECIATION

Does your staff know that you appreciate them? It doesn't cost a lot to show appreciation. Dollar Store gift bags or thoughtful notes don't break the bank but are tangible ways to reach out to your team to let them know that you see them and appreciate their contributions to your company. The best appreciation is communication. When your employees feel heard, they feel respected and it creates that intangible return of Goodwill.



S-Corp cont'd

Hoping this explanation of the S-Corporation is helping our business owners evaluate their current entity and see if any changes would be beneficial to them.

“PLANNING IS BRINGING THE FUTURE INTO THE PRESENT SO THAT YOU CAN DO SOMETHING ABOUT IT NOW”

-ALAN LAKEIN

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S-Corp shareholders can be company employees, earn salaries and receive distributions that are tax free if the distribution does not exceed their stock basis. If it does exceed, the excess is taxed as a capital gain, which is usually a lower rate than ordinary income.

3-Perpetual Existence. S-Corps exist indefinitely. Unlike a LLC, which can dissolve upon the death of its members, S-Corps can last beyond the owner/shareholder’s lifetime.

4-Transference. S-Corp shareholders can transfer their ownership interests more easily than C-Corps and some other business entities.

CONS: 1-More regulations. In addition to filing an annual income tax return (Form 1120-S), if the S-Corp has

employees, quarterly federal returns for employers (Form 941), payroll records, and other reports would now be required. 2-Profit and Losses are strictly allocated on the percentage of ownership or number of shares each individual holds. Whereas in an LLC, you can arbitrarily allocate the percentage of Profits or Losses among the members.

3-Shareholder limitations. An S-Corporation can have no more than 100 shareholders. ALL shareholders must consent to the S-Corp election and sign Form 2553. One shareholder holdout can stop the entire process. S-Corporations cannot have certain types of shareholders such as non-resident aliens, partnerships, corporations, or other S-Corporations.

TAXES: The S-Corporation is taxed as a pass-through to the shareholders, meaning no taxes

are owed by the corporation itself on the yearly federal tax return. Shareholders may be in a more favorable tax position if their income is reduced due to wages being paid out through the corporation instead of having profits that include self-employment taxes.

FINAL THOUGHTS: As LLC businesses grow, it is a general migration for them to move on to become S-Corporations in order to use the salary as a business deduction instead of continuing to pay self-employment tax on business profits. If you are wondering if your company is ready to make the jump from being an LLC or a C-Corp to becoming an S-Corp, reach out to a qualified tax consultant to see what makes the best sense for you.

“Do not save what is left after spending; instead spend what is left after saving.”

-Warren Buffet

“You will never reach your destination if you stop and throw stones at every dog that barks.”

-Winston Churchill

“I have a theory and I really believe it. I think your worst weakness can become your greatest single strength.”

Oprah Winfrey

1-Review your W-2 Withholding! If you are not withholding taxes at what you paid the prior year, adjust your W-2! The Wage Exclusion amounts changed in 2022 and MANY clients have owed taxes who NEVER owed before.

2-Where’s my Refund? Go to [IRS.gov/refunds](https://www.irs.gov/refunds). You need your SSN, filing status, and exact refund amount on your return!



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