

Tax Strategy Memo

"S" Corporations

Why would a professional want their closely-held business to be an "S" corporation?

- **MEDICARE TAX.** As you know, the Medicare tax (1.45% for employees and 1.45% for employers - for a total tax of 2.90%) is applied on all "wages" earned. "S" corporation owner-physicians receive a combination of "wages" and "shareholder distributions" as their compensation. The "shareholder distributions" are NOT subject to the Medicare tax.

Example:

	Doctor - "C" Corporation	Doctor - "S" Corporation
Wages	\$500,000	(1) \$350,000
Shareholder Distribution	-0-	\$150,000
TOTAL COMPENSATION	<u>\$500,000</u>	<u>\$500,000</u>
Social Security Tax	\$13,243	\$13,243
Medicare Tax	\$14,500	\$10,150
Income Tax (35.0%)	\$175,000	\$175,000
TOTAL TAX	<u>\$202,743</u>	<u>\$198,393</u>

- (1) Set at maximum "necessary" retirement plan wages.
- (2) 6.20% for employee and employer - total of 12.40% of the first \$106,800 of wages.

- **AVOIDS CORPORATE INCOME TAX.** While personal income tax rates can be burdensome, corporate income tax on a personal service corporation is 35.0% at the federal level, plus whatever state income tax rate applies in the state(s) where the corporation conducts business. "S" corporations pay no corporate income tax.
- **FLOW-THROUGH LOSSES.** In a regular "C" corporation, losses are of no benefit to the shareholders. Losses can be carried forward to subsequent fiscal years - when they may or may not provide a tax benefit. Losses in an "S" corporation are prorated among the shareholders and can create a deduction on the shareholders' personal returns.

There are some hurdles to the formation of an "S" corporation:

- **BUILT-IN GAINS (BIG) TAX** - A simple conversion from a "C" corporation to an "S" corporation can trigger the BIG tax, which is essentially a tax on your accounts receivable. You can avoid the BIG tax by simply creating a new medical practice corporation which is an "S" corporation from its inception.

*Please note that LLCs can also elect to be S-Corporations.

We look forward to discussing this exciting tax strategy with you in our next on-site visit.