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LLCs and S Corps

The Different Forms of Entities

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In our [September](#), [October](#), & [November](#) issues we discussed retirement, unemployment, & Tax Planning respectively. Since September we've taunted you with issues related to LLC's and how they compare to S Corps. Your patience has paid off and we are delivering on our promise.

Let's start with a brief history. The Limited Liability Company (LLC), first made its debut in Wyoming in 1977. Since then, States have slowly embraced this new form of entity and by 1995 mostly all fifty (50) States accepted LLCs. Like Corporations, LLCs are separate legal entities empowered by the State in which they are created. They are formed by filing Articles of Organization with the appropriate State agency – generally, the Secretary of State, as in Georgia, or State Commissioner's office.

Of all the legal entities that exist in which to operate a business, the LLC is the most flexible. This is because of its tax treatment in the Internal Revenue Service (IRS) Tax Code. Unlike a Corporation, which can only be treated as a C Corp (a double taxation entity), or an S Corp (which generally does not pay income tax), an LLC can make an election with the IRS as to how it will be treated for income tax purposes. As a Single Member (one owner), the LLC can elect to be treated as a Disregarded Entity, filing a Schedule C with the member owner's Individual 1040 income tax return. Alternatively, the LLC can elect to be treated as a C Corp, or an S Corp, should it meet the requirements for S election. A two or more member LLC can also elect to be treated as a Partnership. Each of these forms of operation have their distinct rules under the IRS Tax Code as well as differences on how they operate the business.

From a pure taxation perspective, a primary difference between an LLC and an S Corp is what is routinely called in the industry, the self-employment (SE) tax, which is nothing more than FICA on both, the employee and employer parts of the Social Security and Medicare tax. Each employee pays 6.2% and 1.45% of their gross in tax and this very same amount is matched by the employer for a total 15.3%. When operating an LLC, the member and/or members, are both the employee and the employer and as such, the profit is first subject to the 15.3% SE tax and then it is subject to the federal and state (where applicable) income taxes. Profits in an S Corp are not subject to SE tax, although the Tax Code requires a reasonable salary be paid to its shareholder(s)/employee(s).

Finally, when starting a new business, your first call should be to a CPA. This is because the form of entity that you choose will have tax implications and operating ramifications with which you should be thoroughly familiar. Choosing the wrong form of entity, right out of the gate, can be costly in tax dollars and will adversely affect the operations of the business. This is one area you

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don't want to be penny wise and dollar foolish. Getting the right answers from the onset will strengthen your position to succeed. If you are starting a business, please contact your CPA, or feel free to call on us. www.enccpas.com.

In our next issue you will be shocked on the amount of taxes you are paying and how we have been brainwashed to accept it Until next time, dream big, stay safe, and *always*, be kind 😊

