Automobile Deduction Mini Portal

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An S Corp election shouldn't change much in terms of how you operate your business but there are some important next steps, housekeeping items and considerations. As you navigate business life after an S corporation election, keep in mind that we're here to help!

1. Set Up Payroll Accounts and Processing

As a shareholder of an S corporation, you wear two hats. One as an investor, and another as an employee. Well, that's a lie. As a business owner, in general, you wear a million hats… but two of them are investor and employee. Therefore, the IRS requires all S Corp shareholders who materially participate in the business activities to be **paid a reasonable salary**.

A salary is more than simply writing a check or making a transfer from your business checking account to your personal checking account. Those payments are owner draws and are now considered shareholder distributions. Payroll is payroll… complete with quarterly payroll filings (941s) and annual payroll filings (940, W-2 and W-3). Let's not forget the state equivalents.

Of course, WCG can handle all this for you, but if you choose to process your own payroll we strongly recommend ADP or Gusto. WCG uses ADP.

2. Understand Mileage, Home Office, Cell Phone, Internet Expenses

If you previously reported your business activities on Schedule C of your individual tax return, there are some things to understand. As we just mentioned, as an owner of an S corporation you are both investor and employee. Investors cannot typically deduct mileage, home office, cell phone and internet expense. And! Employees can no longer deduct these expenses either thanks to the Tax Cuts and Jobs Act of 2017 (Form 2106 was eliminated).

As such, your S Corp must reimburse you, the employee, for these expenses through an **Accountable Plan reimbursement program**. While it sounds fancy, the big takeaway here is that these expenses were commonly deducted on your individual tax return, but with an S Corp, these expenses are now employee reimbursements and are deducted on your business entity tax return.

Why does this matter? We commonly prepare and file a business entity tax return just to later have the shareholders want to deduct mileage, home office, cell phone and internet expenses on his or her individual tax return. This is a problem and requires amending the business entity tax return.

Mileage, home office, cell phone and internet expenses are business expenses… that doesn't change. But these "mixed use" business expenses are now deducted on your business entity (S Corp) tax return. Mixed use meaning these expenses are mixed between personal and business use, and therefore should be paid by you personally and reimbursed by your business.

Please don't wait until the preparation of your individual tax return to let us know that you have mileage expenses or a home office to deduct.

3. Understand SEP IRA / 401k Limits and Handling

This can be a big surprise, so please pay attention on this one (pretty please). With business activities reported on Schedule C, SEP IRAs and 401k company contributions are based on net business income after expenses. With an S Corp, they are based on W-2 wages paid to the shareholders. Big difference!


Image Credit: **Daniel Fazio**

One of the reasons for leveraging the tax benefits of an S corporation is to reduce the amounts of Social Security and Medicare taxes (aka self-employment taxes)… and that is accomplished by paying a reasonable salary which is less than the net business income. Here is some math-

A business reported on Schedule C earns $100,000 after expenses. A SEP IRA or 401k company contribution is based on this $100,000 and generally will be close to $18,587 for the sake of argument (25% of net business income after deducting the employer portion of self-employment taxes and adjusting for the contribution factor).

Next assume that this same business being taxed as an S Corp pays out a $40,000 salary to the shareholder. Your SEP IRA or 401k contribution is now limited to 25% of W-2 wages, and would be limited to $10,000.

Wait! There's more. Similar to mileage, home office, cell phone and internet expenses, SEP IRA and 401k company contributions are deducted on the business entity tax return. Read that again. You might have been used to calculating a maximum SEP IRA contribution on your individual tax return in the past; with an S Corp, this calculation and the decision to deduct the contribution is done on the business entity (S Corp) tax return.

4. Know the Filing Deadlines, Biz Tax Payments

March 15. There it is… and this seems to sneak up on small business owners who have not filed a business entity tax return in the past. S Corps (Form 1120S) and partnerships (Form 1065) tax returns are due March 15, or the next business day. C Corps (Form 1120) tax returns are due April 15, or the next business day.

Also, your individual tax return cannot be filed until the business entity (S Corp or Partnership) tax return is completed. Why? An S Corp or Partnership tax return creates a K-1 which must be reported on your individual tax return. Therefore, if you are a DIYer and prepare your own Form 1040, please do not file until you've added the K-1 to the tax return.

Some states have a franchise or corporate tax that affects S corporations and other business entities. For example, if you were a sole proprietor last year and this year you created an entity in California and elected to have that taxed as an S Corp, the business will be required to pay estimated tax payments for franchise taxes. Talk to us for more help and estimation.

Image Credit: **NYPL**

5. Adjust Estimated Tax Payments

One of the primary reasons, if not the only reason, to elect S Corp status is to reduce self-employment taxes (Social Security and Medicare taxes). If your previous accountant or tax return created estimated tax payments based on the previous year's data, those vouchers will include the full amount of self-employment taxes. In addition, with an S Corp election and the processing of payroll, self-employment taxes now become Social Security and Medicare taxes and are handled directly through payroll processing.

As such, your estimated tax payments will be way too high and will need adjustments; in most cases, we can eliminate the need of estimated tax payments completely and handle this within payroll processing by inflating your withholdings.

6. Accounting, Recording Financial Activity

This is an easy one since whatever you've done in the past to memorialize your business transactions remains the same. No, you do not need to instantly add a QuickBooks subscription to your world. While we love QuickBooks Online (QBO) since we can collaborate directly with you, if you have historically used Excel, bar napkins or some other accounting platform, then keep on keeping on. Nothing changes from an accounting perspective with an S Corp. Yes, there are some minor differences when it comes to Capital Stock and the recording of employee reimbursements, but we can chat about that at tax time.

S Corp Obedience School

Need help with your new S Corp puppy? Let's chat!JTVCd2NnLWNvbnRhY3QtdXMlNUQ=**WCG CPAs & Advisors** is a boutique yet progressive business consultation and tax planning accounting firm located in Colorado Springs, Colorado.