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GUIDE

S-Corp vs LLC: When the Election Pays Off

8 min read · Tax Planning

If you're profitable and self-employed, someone has probably told you "you should elect S-Corp status — it'll save you money." That's sometimes true. It's also sometimes a way to pay more in accounting fees than you save in taxes. Here's how to actually tell the difference.

The mechanics, in one paragraph

As a default LLC or sole proprietor, all your net profit is subject to self-employment tax — 15.3% — on top of income tax. Elect S-Corp status, and you split your income into two buckets: a **reasonable salary** (subject to payroll taxes) and **distributions** (not subject to self-employment tax). The savings come entirely from that second bucket.

The break-even math

An S-Corp election isn't free. You'll typically add:

- Payroll processing: ~$600–$1,200/year
- A separate business tax return (Form 1120-S): ~$800–$1,500/year
- Unemployment insurance and payroll tax filings in most states

Call that **$1,800–$3,000/year in added cost**, depending on your state and complexity.

To break even, your self-employment tax savings need to exceed that cost. Rough rule of thumb we use with clients:

Net business profit	S-Corp likely worth it?
Under $40,000	Usually no — added costs eat the savings

$40,000–$60,000	Borderline — depends on your state and reasonable salary
$60,000–$80,000+	Usually yes, if you can pay a defensible salary and still have meaningful distributions left over

> **Example:** A consultant nets $90,000. As a sole proprietor, self-employment tax runs roughly $12,700. As an S-Corp paying a $50,000 reasonable salary, payroll tax on that salary is about $7,650 — a savings of roughly $5,000, minus $2,000–$2,500 in added compliance costs. **Net benefit: roughly $2,500–$3,000/year.**

The part people skip: "reasonable salary"

The IRS requires S-Corp owners to pay themselves a salary comparable to what they'd pay someone else to do their job. Pay yourself $20,000 and take $70,000 in distributions on $90,000 of profit, and you're building an audit case, not a tax strategy. We benchmark salary against BLS wage data and your actual role — this is the single most common area the IRS challenges on exam.

Other things that change with an S-Corp

- You must run actual payroll — no more just moving money to your personal account
- You'll file a separate business return and issue yourself a W-2
- Health insurance and retirement contributions get routed differently through payroll
- You lose a bit of flexibility on retirement plan contribution timing compared to a sole proprietor

When it's *not* worth it

- Profit is inconsistent or seasonal — you still owe payroll taxes even in a slow quarter
- You're already close to the Social Security wage base from another job
- You're planning to sell or wind down the business soon
- You can't clear $40K+ in consistent net profit

Bottom line

The S-Corp election is a tool, not a default. Run your numbers first — we build this break-even model for clients every tax planning season using your actual profit and state, not a generic rule of thumb.