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# Restructuring Business Entity to Minimize Social Security Payroll Taxes







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## What is restructuring a business entity?

### *Restructuring your business entity can minimize Social Security taxes*

If you own a business as a sole proprietorship, you may be able to minimize the Social Security taxes you pay by incorporating your business and causing the business to elect to be taxed as an S corporation. If your business is treated as an S corporation for federal income tax purposes, then you may be able to continue to benefit from a single level of tax on your business earnings, while minimizing the portion of your business earnings that are treated as wages or self-employment income subject to Social Security taxes.

## How does it work?

### *S corporation owners are considered employees of the corporation*

If you own a corporation and perform substantial services as an officer of that corporation, you're not treated as self-employed for tax purposes; rather, you're treated as an employee of the corporation. Because you're not self-employed, you don't pay self-employment taxes. However, as an employee, both you and the corporation have to pay Social Security payroll (FICA) taxes on your salary. If you're both an officer of your corporation and a shareholder, you may be able to reduce the amount of FICA tax you pay by receiving some of your compensation as corporate dividends.

### *Corporate dividends can reduce your payroll taxes*

As a shareholder, you can withdraw earnings from your corporation in the form of dividends. You won't have to pay Social Security payroll taxes on that part of your corporation's earnings, because investment income is not subject to FICA taxes. You will only pay FICA taxes on the wages you receive from the corporation.

## Strengths

### *You can reduce the amount of Social Security payroll taxes you owe*

Incorporating your business and causing it to elect to be taxed as an S corporation can save you money by reducing the amount of Social Security payroll taxes you owe if, as a shareholder of the corporation, you withdraw part of the corporation's earnings in the form of corporate dividends, rather than withdrawing such earnings as wages.

## Tradeoffs

### *Setting up a corporation can be expensive*

Operating a sole proprietorship is simpler and less expensive than operating a corporation. If you incorporate your business and elect for it to be taxed as an S corporation, you will have to pay incorporation fees, and you may have to hire accounting, tax, or legal professionals to advise you. There are a number of requirements that must be satisfied for a corporation to be eligible to elect to be taxed as, and continue to qualify as, an S corporation.

### *The Internal Revenue Service (IRS) may challenge your compensation structure*

The IRS may audit your business and it may recharacterize all or a portion of any dividends distributed by the corporation to you as wages if it believes that the corporation is paying you compensation that is unreasonably low in order to avoid Social Security taxes. To avoid this, you must pay yourself an annual salary that is reasonable considering the work you actually do for the corporation during the year. (The IRS may, in certain circumstances, challenge unreasonably high compensation as well.)



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