

LLC vs S-Corp

What's the difference between an LLC & an S-corp? The reality is that they aren't even comparable - but they often get talked about together. So, let's clear that up for you below!

LLCs and S corporations are two different types of businesses. They both have their own benefits and drawbacks, but they are not mutually exclusive - meaning you can have both types of businesses in operation at the same time.

Key Takeaways:

- While an **LLC is a business structure**, an **S-corp is a tax classification**.
- You can form a business as an LLC and, if it passes the requirements of the IRS, you can get it taxed as an S-corporation.

Can you form an LLC and file it as an S-corp?

Yes, dozens of business owners choose this path to amplify their tax benefits. However, before going on this path, make sure to know how and when these tax advantages apply. While you may face initial confusion in understanding business structures and tax incentives, understanding them now can save you time, money, and headaches later on.

In this article, we'll go through the factors you need to consider when forming an LLC and whether to get it taxed as an S-corp, or not.

LLC vs. S-Corp: Basic Definitions

What is an LLC?

A limited liability company (LLC) is a hybrid business entity that combines the benefits of a sole proprietorship and a corporation. One of the benefits of having an LLC business structure is its pass-through taxation, which allows business owners to pay income taxes only once on their personal tax returns. Meaning they don't have to pay twice for the same business earnings or source of income (avoids double taxation).

LLC Ownership

The LLC owners are called their members. It can be a single ownership type like a sole proprietorship or a multi-member ownership, which is referred to as a partnership.

What Type of Business Qualifies as an LLC?

Because LLCs allow profit-sharing with liability protection and are much more flexible than other business types, they are a great choice for individuals, startups, and corporations.

LLCs are by far the most flexible business structure for entrepreneurs, freelancers, small businesses, and mid-size enterprises.

However, it is important to note that businesses such as banks and insurance companies cannot become LLCs. (why?)

LLC Tax Classifications

Now here comes the exciting part where we can relate an LLC to an S-corp.

An LLC doesn't have an IRS tax classification. Unlike other business forms such as partnerships or corporations, having an LLC lets you choose which tax classification you'd like to consider (depending on if your business qualifies).

There are three LLC tax classifications: disregarded entity, partnership, and corporation. If you choose to file under 'corporation,' you can further classify this into an S corporation or a C corporation.

LLC tax classifications:

- **Disregarded Entity** - A business taxed as a disregarded entity has (1) one owner or a one-member LLC. (2) Your business isn't structured as a corporation. (3) The owner reports his/her income under his/her federal tax returns. This means if you choose to have a disregarded entity, taxes owed by your business are paid as part of your income tax return.
- **Partnership** - Multi-member LLCs can be taxed as a partnership. This means that the profits and losses from the LLC are passed through to the individual members, who are then taxed on them. Even if the members don't actually receive any of the profits (or the profits are left in the LLC's bank account), they are still taxed on the members as though they had received them.
- **Corporation** - Whether you're a single-member or a multi-member LLC, you can choose to be taxed like corporations. For this, your LLC business and individual members have reporting requirements. However, choosing the S corporation status lets you avoid paying federal taxes on the business income. Instead, it will pass through to the owner of the LLCs individual taxes.

We can summarize these concepts below:

Business Entity	Default Tax Classification	Pros	Cons	Other Possible Tax Status
Single-member LLC	Disregarded Entity	• Easy tax filing • Pass-through taxation • Avoids double taxation	• Members taxed for the money left in the business • Possibly paying taxes for self-employment	S-Corporation C-Corporation
Multi-member LLC	Partnership	• Simplicity • Avoids double taxation	• May be unfavorable for non-active members or business investors.	S-Corporation C-Corporation
Corporation	C Corporation	• Good for investors	• Double-taxation	S-Corporation
LLC (taxed as S-Corporation)	S-Corporation	• Avoids double taxation • Have certain tax advantages	• May be unfavorable for non-active members or business investors.	

Choosing a tax strategy for the LLC will depend on the business goals, financial status, and business size of the LLC.

Want to learn more about LLCs? Check out our [guide](#) on how to set one up.

LLC Business Operations

LLCs have a much simpler business operation than any other business type and there are only a few requirements that business owners are required to satisfy. LLCs are usually encouraged to follow some of the guidelines for S corporations, such as holding annual meetings and adopting its bylaws. However, they're not legally required to do so. This is one example of why LLCs have more flexibility in their business operations.

Management Structure of an LLC

When forming an LLC, the owners have the option of electing to have the owners or designated managers occupy the company management positions. If they choose to have the owners occupy these positions, the business will operate similar to a partnership. This would give the owners more control over the business and how it is run.

However, it is important to note that this option is not required, and the LLC can elect to have the managers run the business if they so choose. This flexibility is one of the many benefits of forming an LLC.

What is an S Corp?

S corps and nonprofits (such as private foundations) are more so a tax status than a business structure. In many cases, an S Corporation is considered a tax status and not a business entity. Both LLCs and corporations can be taxed as an S corp, saving owners a great deal of money on their taxes.

S Corp Ownership

According to the IRS, an **S corporation is allowed to have 1 to 100 shareholders**. Meaning an S corp can be owned by one all the way up to a maximum of 100 individuals.

What Type of Business Qualifies as an S Corp

While an S corp might seem like the ideal tax structure for you, not all businesses can qualify to have it. These things should be taken into consideration before filing for an S-corp status:

- You would have to be a U.S. business
- You should not exceed more than 100 shareholders. This means your corporation cannot go public.
- Shareholders/owners may be individuals, trusts, or estates.
- Shareholders must not be a corporation, non-resident aliens, or partnership entities.
- Only one stock or class is allowed for S corps

S Corp Tax Classifications

S corporations are a popular choice for small businesses because of the many tax benefits they offer. One of the biggest advantages is that S corporations avoid double taxation from C corps.

C Corp to S Corp Taxation

If you have a corporation, choosing an S corp tax status gives you the benefit of avoiding double taxation (one from the corporate profits and the shareholder level)

- C corporations are taxed on profits at the corporate level and then again at the personal level when dividends are distributed to shareholders.
- S corporations pass through their income to shareholders, who are then taxed on it only once. This saves business owners a significant amount of money in taxes.

In addition, S corporations offer protection for business owners' personal assets. If the corporation is sued or incurs debt, shareholders' personal assets are not at risk. This makes S corporations an attractive option for those looking to start a small business

LLC to S Corp Taxation

If you have an LLC business, an S Corp taxation can tax you like a company employee so you can save more on taxes.

S Corp Business Operations

Here's how it works: an S Corp doesn't pay corporate income tax as a traditional C corp does. Instead, company profits pass through to the owners' personal tax returns. This means that owners only have to pay taxes on their personal income, not on the company's profits. This can be a huge benefit for small businesses.

Management Structure of an S Corp

The board of directors and corporate officers are the two main groups that manage an S corp. The board of directors is responsible for making major decisions about the company, such as setting strategy, approving budgets, and hiring and firing the CEO.

The corporate officers, on the other hand, are responsible for managing the company's business operations on a day-to-day basis. The CEO is typically in charge of overall strategy and decision making, while the CFO is responsible for financial management and reporting. Both the board of directors and corporate officers play important roles in ensuring that a company runs smoothly.

What's the Difference Between an LLC and an S Corporation?

LLC vs S Corp Advantages & Disadvantages

One of the few reasons why a lot of people don't elect to be taxed as an S corp is that there is more paperwork to do and more requirements to satisfy.

Advantages of LLC	Disadvantages of LLC
• flexibility in management and ownership structure.	• maybe subject to self-employment taxes

• fewer formalities and paperwork requirements than corporations • not subject to double taxation • you can easily split up financial interests.	• Profits or losses from an LLC flow through to the owners, creating personal liability issues.
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Because an LLC can be taxed as an S corp, the advantages of the S corp are based mainly on the differences between corporations (C corporations) and LLCs in general.

Advantages of S Corp	Disadvantages of SCorp
• limited liability protection • offer tax benefits for shareholders • have limited liability protection for shareholders • have a more flexible ownership structure than LLCs	• have more formalities and paperwork requirements than LLC - mistakes can result in losing your S corp status • higher cost of incorporation

Cost of LLC vs S Corp

- **Starting an LLC costs around \$50 to \$500**
- **Incorporating an S corp range between \$100 to \$250**

For starting an LLC, the cost varies depending on the requirements of each state and the method by which you will incorporate your LLC. Some choose to do it on their own by hiring a lawyer and incorporating it by themselves. The more popular and easiest way to start an LLC is by registering online through a legal service such as Incfile.

(LINK)

If you want to incorporate an S corp tax status, the cost may vary depending on the state and cost of the legal requirements.

Management Structure

- **S corps** - managed by Board of Directors and organized as traditional corporations, with shareholders, directors, and officers
- **LLC** - managed by owners or “members” and there is no need to hold formal board meetings or take minutes

Stocks and Shareholders

- **S corps** - Issue common stock to shareholders
- **LLC** - No shareholders or stock

Employment of Owner

- **S corp** - Owner takes salary as an employee
- **LLC** - Owners can choose to participate in the management of the organization or not

Taxes

Corporate profits from partnerships or sole proprietorships are subjected to a 15.3% self-employment tax and a personal income tax rate.

S corps are not subject to this tax. Business owners are only required to pay tax on profits paid as salary to people that work with them and then an individual personal income tax rate.

On the other hand, a C corp or large corporation is ideal for businesses that want to grow with more than 100 investors. However, you will be taxed double with C corp since tax is charged at the corporate and individual shareholder levels.

Another benefit of S corp in terms of taxes is the FICA tax. Owners of an S corporation pay themselves wages subject to FICA tax. However, the remaining profits only need to pay income tax, not including a FICA tax.

Example:

Say you have a business that makes \$1,000,000 annually. You receive a \$100,000 wage from it and the rest is considered as business profit. Now, here's how your taxes will move if you switch from an LLC Partnership tax status to an LLC S corp status.

How FICA Tax Works:

	S Corp	Partnership
Business Income	1,000,000	1,000,000
Owner Wages	100,000	-
Payment Guaranteed to Owner	-	100,000
Remaining Business Taxable Income	900,000	900,000
FICA Tax on Owner Wages	15,300	0
FICA Tax on Payment Guaranteed to Owner	0	14,130
FICA Tax on Remaining Business Taxable Income	0	28,573
Total FICA Tax Owed	15,300	42,703

The sample computation shows how moving from an LLC partnership to an S corp tax status can have a potential saving of \$27,000 annually on FICA Tax.

Your choice will affect how taxes are filed and how much personal liability protection you have. In most cases, LLCs offer more flexibility than corporations. If you're just getting

started, it's best to consult with a tax professional before deciding on which business structure is more suitable for you.

[Investing Taxes Explained: Full Beginner's Guide \(2022\)](#)

Formation

If you want to form an LLC and get taxed as an S-corp, there are 2 separate processes.

Forming an LLC:

- Name your LLC
- Choose a registered agent
- File articles of organization with your state.
- Create an LLC operating agreement that states the ownership structure
- Register your local business license
- Choose your tax status for the company upon applying for an EIN

WATCH: [How to Form an LLC](#)

Tax Status as an S Corp

To have a tax status of an S corp, you need to file [Form 2553 Election by a Small Business Corporation](#) from the IRS. This form confirms that your business is eligible based on the number of shareholders - there must be at least one and no more than 100.

The business must also follow certain operating procedures to maintain S corporation status. For example, the business must hold regular meetings of directors and shareholders, and the minutes of these meetings must be recorded according to the company's bylaws.

Additionally, some states charge an annual filing fee for S corporations. You can check with your state's business office to see if this fee applies to your business.

Is an LLC taxed as an S Corp Right for You?

There are a few key reasons why an S corporation tax classification might be the best choice for your business.

- S corporations allow you to contribute more money to retirement plans. This can be a big advantage if you're looking to scale your business.
- S corporations offer some tax breaks that can help position your company for growth.
- S corporations have stricter requirements for payroll and tax forms. While this might seem like a hassle, it can actually be a good thing if your business is consistently growing.

As an LLC, you are required to pay a 15.3% self-employment tax on your profits. This can be a significant amount, especially if your business is doing well.

So, if you're looking to scale your business or position it for growth, an S corporation might be the best option for you.

When is an S-corp not Good for You?

There may be instances when an S corp is not the best business tax status for you. For example, if you are concerned about personal liability or want to minimize business upkeep, you might want to establish an LLC without incorporating an S corp status.

LLCs have fewer legal requirements and reporting obligations than corporations. Additionally, anyone – including partnerships, corporations, or noncitizens – can own or partially own an LLC. However, LLCs are required to file an annual or biennial report detailing any changes in members, business locations, etc.

Special Considerations

If you want to have the most [protection for your personal assets](#), it is a good idea to get investments from outsiders. You might also want to think about becoming a publicly-traded company. To do this, you would need to form a C corporation and then make the S corporation tax election.

Remember that the S corporation designation is just a tax choice. This means that your business will be taxed based on Subchapter S of Chapter 1 of the IRS Code. The S corporation might start out as another kind of business entity, such as a sole proprietorship or LLC.

FAQ

Who Pays More Taxes, an LLC or S Corp?

The amount of taxes that a business pays depends on how the business is set up for tax purposes and how much profit is generated. LLCs and S corps can both be taxed at the personal income tax level.

LLCs are often taxed using personal rates, but some LLC owners choose to be taxed as a separate entity. This means that they have their own federal ID number. S corporation owners must be paid a salary and they pay Social Security and Medicare taxes.

However, dividend income or some of the remaining profits (after the owner's salary has been paid) can be passed through to the owner, but not as an employee. This means that they won't pay Social Security and Medicare taxes on those funds.

Can You Switch from an LLC to an S Corp?

It is possible to change your LLC's tax status to that of an S corporation, as long as it meets the IRS's requirements. You don't have to alter your business structure, but you will need to submit a form to the IRS.

How Can I Save on Taxes With an S Corporation Status?

[7 TOP Tax Deductions for Self-Employed in 2020 \(Save Money!\)](#)

1. You can limit your self-employment tax

Having an LLC taxed as an S Corp can reduce self-employment tax, unlike non-S corp LLCs. Read the section on [taxes](#).

2. Deduct Medicare/Health Insurance with an S corp

You can certainly write off health insurance with an S corp tax status. You can even reduce your Social Security taxes.

3. Deduct Home Office Expenses

With an S corp status, you can write off a lot of your home office expenses as tax deductibles under an Accountable Plan. In other words, the S corporation can pay you for the costs of a home office as an employee business expense but you have to prove the money was spent on business expenses.

In order for you to do that, you must substantiate expenditures with documented support. You can easily record your expenses and take pictures of receipts with the QuickBooks Online app.

4. Write off Employee Wages and Salary

You can write off employee payroll taxes and wages.

5. Retirement Plans

One of the biggest benefits of an S corporation is that it can take advantage of retirement plans. By setting up a retirement plan, an S corporation can deduct contributions from its income and provide its employees with a way to save for the future.

There are many different types of retirement plans available, so it's important to speak with a financial advisor to find the best option for your business. However, there is no doubt that a retirement plan can be a valuable tool for any S corporation. By taking advantage of this benefit, you can help your business save money and attract and retain talented employees.

LLC or S Corp for Ecommerce: Which is Better?

While the most popular business structure for an eCommerce business is Sole Proprietorship or Partnership, you may want to choose an LLC for maximizing your liability protection and tax savings. An LLC can help you have a distinction between you and your business earnings and if ever the business incurs debts, your personal assets aren't liable. If your eCommerce business is already making a lot of profit, choosing an LLC business structure taxed as an S Corp may get you the best tax and legal benefits. These include taking advantage of retirement plans, avoiding corporate tax rates, fringe benefits, and a lot more.

LLC or S Corp for Flipping Houses: Which is Better?

An S corporation can be an ideal business tax status for real estate investors and house-flippers who are earning a lot of money. If you regularly flip real estate, your profits and losses are taxed as ordinary income and loss. This isn't really a bad thing if you're earning less than \$100,000 on annual profits.

However, ordinary income tax isn't ideal for flippers who are earning over \$100,000 or more in flipping houses. This is because you'd have to pay income taxes and self-employment taxes. Aside from paying your income tax as a real estate flipper, you also need to pay 15.3% self-employment tax on your \$100,000 annual profit and 2.9% self-employment tax on profits above \$100,000.

However, if you have an LLC taxed as an S corp, you only need to pay an employment tax for that portion of the profit given out as wages.

For example, you have an S corp and you earn \$100,000 in profit. From that amount, you pay \$60,000 out as salaries, and the \$40,000 is paid as a shareholder dividend. For this scenario, the employment tax is 15.3% of the \$60,000 of wages, or \$9,180. Having an S corporation saves you about \$6,120.

Improve LLC and S Corp Incorporation

With [IncFile](#), you can easily form an LLC and incorporate an S Corp tax status.

IncFile is an online service provider that has an excellent customer support team, generous pricing, and great incentives for starting an LLC.

IncFile offers both free plans and paid plans depending on your budget. If you're looking into starting an LLC taxed as an S corp, IncFile can easily incorporate this for you. Their basic plan includes LLC name availability verification, tracking processing status online, free tax consultation services, next-day article processing and preparation and filing, and lifetime support service. The only thing you need to pay at a minimum is the state fee. You also have the option to add on additional services, like EIN or IRS Form 2553 filing, to your base package.

Wrapping Up

LLCs taxed as S corps is a business structure that can offer some tax benefits. For one, if you have a business, structuring it as an LLC can be much simpler and easier for you to maintain. There are fewer legal regulations to satisfy reporting requirements. If you're planning to grow your business, seeking outside financing, or possibly want to issue common stock, choosing an S corp tax status might be the best option for you.

Do take note that while it is possible to change the structure of your business, if the nature of the business changes and requires it, it might involve incurring a tax penalty of one kind or another. Hence, it is usually best if the business owner can determine the most appropriate business entity choice when first establishing the business.

S corporations are a type of corporation that allows businesses to enjoy the legal protections of a corporation, while also being able to take advantage of certain tax benefits.

Furthermore, each state has its own laws regarding incorporation, so it is important to consult with a corporate lawyer or accountant who is familiar with the laws in the state where the business will be located.

