TAX · ACCOUNTING · ADVISORY

The Small Business Owner’s Guide to the

S-Corporation Election

How an S-Corp election can lower self-employment tax for a single-member LLC — what it is, when it pays off, what it costs, and how to stay compliant.

What you’ll find inside

- The self-employment tax problem the election solves
- A worked example with real 2026 numbers
- The “reasonable compensation” rule — the heart of staying compliant
- Costs, trade-offs, deadlines, and a readiness checklist

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“No need to worry, my accountant handles that.”

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1. The Big Idea in One Page

If you run a profitable single-member LLC, every dollar of profit is hit with self-employment tax on top of regular income tax. That self-employment tax is 15.3% — and it is often the single largest tax a successful owner pays before income tax even starts.

An S-corporation election does not change your legal entity. Your LLC stays an LLC. It only changes how the IRS taxes your profit. After the election, you split your business income into two buckets:

- **A reasonable salary** you pay yourself through payroll. This is subject to payroll tax (the same 15.3%, just split into employer and employee halves).
- **Distributions** — the remaining profit, paid to you as the owner. This is *not* subject to self-employment or payroll tax.

That second bucket is where the savings live. You still pay income tax on all of it — the election does not reduce income tax — but you stop paying the 15.3% layer on the distribution portion.

> **The one-sentence version**
> Pay yourself a fair salary, take the rest as distributions, and you legally avoid the 15.3% self-employment tax on the distribution portion — as long as the salary is genuinely reasonable.

> **Is it worth it for me? A quick gut-check**
> The election generally starts to pay off once your net business profit reliably clears about $60,000 per year. Below that, the added costs — a separate tax return, payroll, and compliance — tend to outweigh the savings. Above it, the savings grow as the gap between your salary and your total profit widens.

2. The Problem: Self-Employment Tax

As a single-member LLC, the IRS treats your business as a “disregarded entity.” All of your profit flows onto your personal return on Schedule C, and all of it is treated as self-employment earnings.

What makes up the 15.3%

Component	Rate	Applies to
Social Security (OASDI)	12.4%	Net earnings up to the annual wage base ($184,500 in 2026)
Medicare (HI)	2.9%	All net earnings — no cap
Additional Medicare	0.9%	Earnings above $200,000 (single) / $250,000 (married filing jointly)

Self-employment tax is calculated on 92.35% of your net earnings, and you get to deduct one-half of it for income tax purposes. But the headline remains: on the Social Security band, you are paying roughly fifteen cents of every profit dollar to payroll-type taxes before income tax is even considered.

> **Why this hurts successful owners most**
> The Social Security portion only applies up to the wage base each year. Once your salary covers that band, additional distributions escape the 12.4% entirely. That is exactly the lever the S-corp election pulls.

3. How the S-Corp Election Fixes It

After electing, your LLC is taxed as an S-corporation. Mechanically, three things change:

1. **You go on payroll.** You become a W-2 employee of your own company and pay yourself a reasonable salary. The company withholds and remits payroll taxes on that salary.
2. **You file a separate return.** The business files its own return (Form 1120-S) and issues you a Schedule K-1 reporting your share of the profit. Profit still flows to your personal 1040 — the S-corp itself pays no federal income tax.
3. **You take distributions.** Profit above your salary comes to you as distributions, free of self-employment and payroll tax.

The same dollar, taxed two ways

Picture $150,000 of profit. As a sole proprietor, the whole amount is exposed to SE tax. As an S-corp paying a $70,000 salary, only the salary carries payroll tax — the remaining $80,000 does not.

On $150,000 of profit	Single-Member LLC	S-Corp Election
Earnings exposed to 15.3%	$138,525*	$70,000
Distributions (no SE/payroll tax)	$0	$80,000
Payroll / SE tax	**~$21,194**	**~$10,710**
Approximate tax saved		**~$10,484**

** Sole-proprietor SE tax is figured on 92.35% of net profit. Figures use 2026 rates and are rounded; your numbers will differ.*

The catch you must respect

Notice the salary is what makes this legal. The IRS lets you take distributions free of payroll tax only because you first paid yourself a reasonable wage for the work you do. Set the salary too low and the whole structure is exposed. Section 5 covers this in depth.

4. A Worked Example at Three Income Levels

Savings scale with profit. The table below shows approximate net self-employment / payroll tax saved (before service costs) at a salary set near half of profit — a common, defensible starting point for many service businesses.

Net profit	Reasonable salary	Distribution	Approx. tax saved
$80,000	$50,000	$30,000	**~$3,650**
$150,000	$70,000	$80,000	**~$10,484**
$200,000	$90,000	$110,000	**~$14,000+**

Figures are illustrative 2026 estimates before the cost of payroll, the 1120-S return, and compliance support. Your accountant will model your specific numbers.

Savings are real, but net of costs

Running an S-corp adds a separate tax return, payroll, and bookkeeping discipline — typically $2,500–$3,500 per year all-in for a single-owner business. We always net those costs against the gross savings so the decision is based on the true benefit, not the headline number.

The accompanying Motta S-Corp Savings Calculator lets you enter your own profit and salary and see the net benefit after costs instantly. Ask your advisor for a copy populated with your figures.

5. Reasonable Compensation — The Rule That Matters Most

This is the single most scrutinized part of S-corp taxation. The IRS requires that an owner-employee who provides services be paid “reasonable compensation” — roughly, what you would have to pay someone else to do your job — before taking distributions.

Why the IRS cares

Because distributions avoid payroll tax, there is a natural temptation to pay a tiny salary and take everything else as distributions. The IRS knows this. If your salary is unreasonably low, it can reclassify distributions as wages and assess back payroll taxes, interest, and penalties — wiping out years of savings.

How a reasonable salary is determined

There is no magic percentage in the law. “Half of profit” is a common rule of thumb, not a safe harbor. A defensible figure is built from facts:

- The actual duties you perform and the hours you work
- What comparable businesses pay for that role and skill in your market
- Your experience, certifications, and the revenue your labor drives
- How much of the profit comes from your personal work versus invested capital or staff

> **Documentation is your defense**
>
> If your salary is ever questioned, the winning answer is a paper trail. Keep:
>
> - A written job description for your role
> - Market salary data or a compensation study supporting the figure
> - A short memo explaining how you set the number each year
> - Consistent payroll records and W-2s

Red flags that invite scrutiny

- A salary of zero while taking substantial distributions
- A salary that suddenly drops from one year to the next without explanation
- Distributions taken with no payroll run at all
- A salary wildly out of step with industry norms for your role

Motta sets your reasonable compensation using market data and documents the basis for it — so the position is supportable if anyone ever asks.

6. The Real Costs and Trade-Offs

The election is not free, and it adds permanent obligations. Going in with eyes open is the point of this section.

New recurring obligations

Obligation	What it means for you
Run payroll	You must pay yourself through a real payroll system, withhold taxes, file quarterly Forms 941, and issue a W-2 each January.
File Form 1120-S	A separate federal S-corp return is due each year (March 15), with a Schedule K-1 to you. Late filing carries per-month, per-shareholder penalties.
Track basis	You must track your stock and debt basis (Form 7203) to support distributions and loss deductions.
Keep clean books	Distributions and payroll must be recorded properly; commingling funds undermines the structure.
State filings	Some states impose franchise taxes or fees on S-corps (for example, California's 1.5% franchise tax with an $800 minimum). Your advisor will confirm your state.

Typical annual added cost

For a single-owner business, plan on roughly $2,500–$3,500 per year all-in for the incremental tax return, payroll service, and compliance support. That is why the election rarely makes sense below about $60,000 of profit — the costs eat the savings.

Things to weigh beyond the tax savings

- **Lower Social Security earnings.** A smaller salary can modestly reduce your future Social Security benefit, since benefits are based on wages.
- **Retirement contributions.** Some retirement-plan contributions are tied to W-2 wages; an artificially low salary can limit them.
- **Loan and mortgage qualification.** Lenders often look at W-2 wages; a low salary can affect borrowing.
- **The §199A (QBI) interaction.** The 20% qualified business income deduction interacts with wages and can change the optimal salary at higher incomes.
- **Administrative discipline.** Missing a payroll run or a filing deadline carries penalties. The structure rewards consistency.

7. Deadlines and How the Election Is Made

The election is made on Form 2553. Timing controls when it takes effect.

Key timing rules

- **For an existing business:** file by the 15th day of the third month of the tax year you want it to take effect — generally March 15 for a calendar-year business.
- **For a new business:** file within 2 months and 15 days of the date the business begins.
- **Missed the deadline?** Late-election relief is often available under IRS Revenue Procedure 2013-30 if you have a reasonable cause and have operated consistently as an S-corp. This is routine — but it requires a proper reasonable-cause statement.

Good news for LLCs

A single-member LLC does not need to file a separate entity-classification form first. Form 2553 handles the classification change for you. Your LLC stays an LLC at the state level; only the federal tax treatment changes.

The path, start to finish

4. **Analyze.** Confirm the savings exceed the costs for your situation, and set a defensible reasonable salary.
5. **Elect.** Prepare and file Form 2553 (timely, or with late-relief language if needed).
6. **Set up payroll.** Open payroll tax accounts, configure a payroll system, and schedule your salary.
7. **Operate.** Run payroll on schedule, take distributions properly, and keep clean books all year.
8. **File.** Prepare the annual Form 1120-S and K-1, track basis, and reconcile wages to profit.

8. Is the S-Corp Election Right for You?

Use this readiness check. The more boxes you can tick, the stronger the case.

Signs it likely makes sense

- Net profit reliably exceeds about $60,000 per year
- Much of your profit comes from your personal work, not just invested capital
- You expect profit to stay steady or grow
- You can commit to running payroll and filing on time, every period
- You want to formalize a salary for lending or retirement-planning reasons

Signs it may be premature

- Profit is below ~$50,000 or is volatile year to year
- Nearly all profit would have to be paid out as salary anyway (little room for distributions)
- You are not ready for the added administrative discipline
- You may close or substantially change the business soon

> **The honest answer**
>
> For many profitable single-member LLCs, the election saves real money every year for as long as the business runs. For others, it is simply not worth the overhead yet. The only way to know is to run your actual numbers — which is exactly what we do before recommending it.

9. How Motta Helps

We handle the entire election end-to-end so you capture the savings without taking on the compliance risk.

- **Savings analysis.** We model your specific numbers and show the net benefit after all costs — no guesswork.
- **Reasonable compensation, documented.** We set a defensible salary using market data and keep the support on file.
- **The election itself.** We prepare and file Form 2553, including late-relief language if you missed the deadline.
- **Payroll setup.** We stand up payroll accounts and a system so your salary runs cleanly.
- **Ongoing compliance.** We prepare your annual Form 1120-S and K-1, track basis, and keep the structure sound year after year.

Talk it through with us

Every situation is different, and the right salary and the worth-it threshold depend on your facts. We’re happy to run your numbers and walk you through the decision in plain English — before any commitment.

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