



A FIRST-YEAR OWNER'S GUIDE

# Becoming an S-Corporation

EVERYTHING YOU NEED TO KNOW & DO

From deciding whether the election is right for you to payroll, deadlines, and staying compliant — a plain-English roadmap for your first year and beyond.

**15.3%**

self-employment tax  
the structure can reduce

**MAR 16**

annual return  
(Form 1120-S) deadline

**W-2**

reasonable salary is  
required before profit

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**FOR**

New & prospective S-Corp owners

# 01 IS AN S-CORP RIGHT FOR YOU?

An S-corporation isn't a type of company — it's a **tax election**. You can elect it for an LLC or a corporation. What it changes is how the IRS taxes your business income. For the right owner it can save thousands a year in self-employment tax; for the wrong one it adds cost and paperwork with little benefit. The question is which one you are.

## LIKELY A GOOD FIT IF...

- ✓ Your business nets roughly **\$80,000+** in profit after expenses
- ✓ That profit is fairly steady and predictable
- ✓ You actively work in the business
- ✓ You're comfortable running payroll for yourself
- ✓ You want to lower self-employment tax

## PROBABLY WAIT IF...

- ✗ Profit is below ~\$50,000 or still ramping up
- ✗ Income is highly irregular year to year
- ✗ You're reinvesting nearly everything back in
- ✗ You don't want payroll and extra filings yet
- ✗ The business is brand new with little track record

## THE RULE OF THUMB

The savings only start once your profit comfortably exceeds the salary you'd reasonably pay yourself. Below that line, payroll costs and filing fees can eat up the benefit. We run the numbers for your specific situation before recommending the election — never the other way around.

## 02 HOW S-CORP TAXES WORK

As a sole proprietor or standard LLC, **all** of your net profit is hit with 15.3% self-employment tax (Social Security and Medicare) on top of income tax. An S-corp splits your income into two buckets and only one of them carries that 15.3% load.

### BUCKET 1 — SALARY

A **reasonable W-2 salary** you pay yourself for the work you do. This portion is subject to payroll taxes (the 15.3%), just like any employee's wages.

### BUCKET 2 — DISTRIBUTIONS

The **remaining profit**, paid out to you as an owner. This portion is **not** subject to the 15.3% payroll tax — which is exactly where the savings come from.

### QUICK EXAMPLE

\$120,000 net profit

Say your business nets **\$120,000**. As a sole proprietor, all \$120,000 faces self-employment tax. As an S-corp, you might pay yourself a **\$70,000** reasonable salary and take the remaining **\$50,000** as a distribution. Only the \$70,000 is hit with the 15.3% — the \$50,000 is not. That difference is roughly **\$7,650** in payroll tax you keep, every year.

### THE CATCH

The IRS requires the salary to be **reasonable** for your role — you can't pay yourself \$0 and take everything as distributions. Setting that number correctly is the single most important decision an S-corp owner makes, and we cover it in detail on page 6.

## 03 THE BENEFITS

The self-employment tax savings get the headlines, but a well-run S-corp brings several advantages worth understanding.

### 1 Lower self-employment tax

Only your salary is subject to the 15.3% payroll tax; distributions are not. For a steadily profitable business, this is the core annual saving.

### 2 Pass-through taxation

The business itself generally pays no federal income tax. Profit flows to your personal return via a Schedule K-1, avoiding the double taxation a C-corp faces.

### 3 Qualified Business Income (QBI)

S-corp owners may still claim the 20% QBI deduction on their share of business income, subject to the usual limits.

### 4 Builds Social Security credit

Because you pay yourself a real W-2 salary, you continue earning Social Security and Medicare credit on those wages.

### 5 Cleaner books & credibility

Running payroll and formal distributions forces clean bookkeeping, which helps with financing, due diligence, and an eventual sale.

### 6 Retirement leverage

A W-2 salary opens the door to powerful owner retirement plans (Solo 401(k), SEP) with higher contribution room.

### WHICH APPLY TO YOU?

Benefits depend on your numbers and how disciplined you are about payroll and records. We'll show you which of these actually apply to your business before you elect.

## 04 YOUR SETUP CHECKLIST

Here is the full path from decision to a properly running S-corp. We handle the filings; you'll mainly need to make decisions and provide information.

- Confirm the election makes sense**  
We run your projected savings against the added payroll and filing costs to confirm it's worth it.
- Have an LLC or corporation in place**  
You need an underlying entity first. If you're a sole proprietor, we form the LLC before electing.
- File Form 2553 (the S-election)**  
This is the election itself. Timing matters — generally within 75 days of formation or by March 15 to apply for the current year.
- Get an EIN and register for payroll**  
Federal and state payroll accounts must be open before you can run a single paycheck.
- Set your reasonable salary**  
We document a defensible salary figure for your role (see page 6) before the first payroll runs.
- Start running payroll**  
At minimum, run payroll and issue yourself a W-2. Don't wait until December — start early in the year.
- Open a dedicated business bank account**  
Keep business and personal money fully separate. Distributions flow from this account.
- Set up clean bookkeeping**  
Accurate books are non-negotiable for an S-corp. We can set up or review your system.
- Plan quarterly estimated taxes**  
You'll pay estimates personally on your share of profit. We build a payment schedule so nothing surprises you.

## 05 SETTING A REASONABLE SALARY

This is where most S-corp trouble starts. The IRS requires you to pay yourself a salary that reflects the real value of the work you do **before** taking distributions. Pay too little and you invite an audit; pay too much and you give back the savings. There's no single magic number, but the IRS looks at a consistent set of factors.

### Your role & duties

What you actually do day to day, and the skill it requires.

### Time devoted

Full-time owner-operator vs. a few hours a week.

### Comparable wages

What someone else would be paid to do your job in your market.

### Training & experience

Your credentials, expertise, and years in the field.

### What the business can pay

Salary should bear a sensible relationship to revenue and profit.

### Profit vs. salary split

A salary that's a tiny fraction of large profits draws scrutiny.

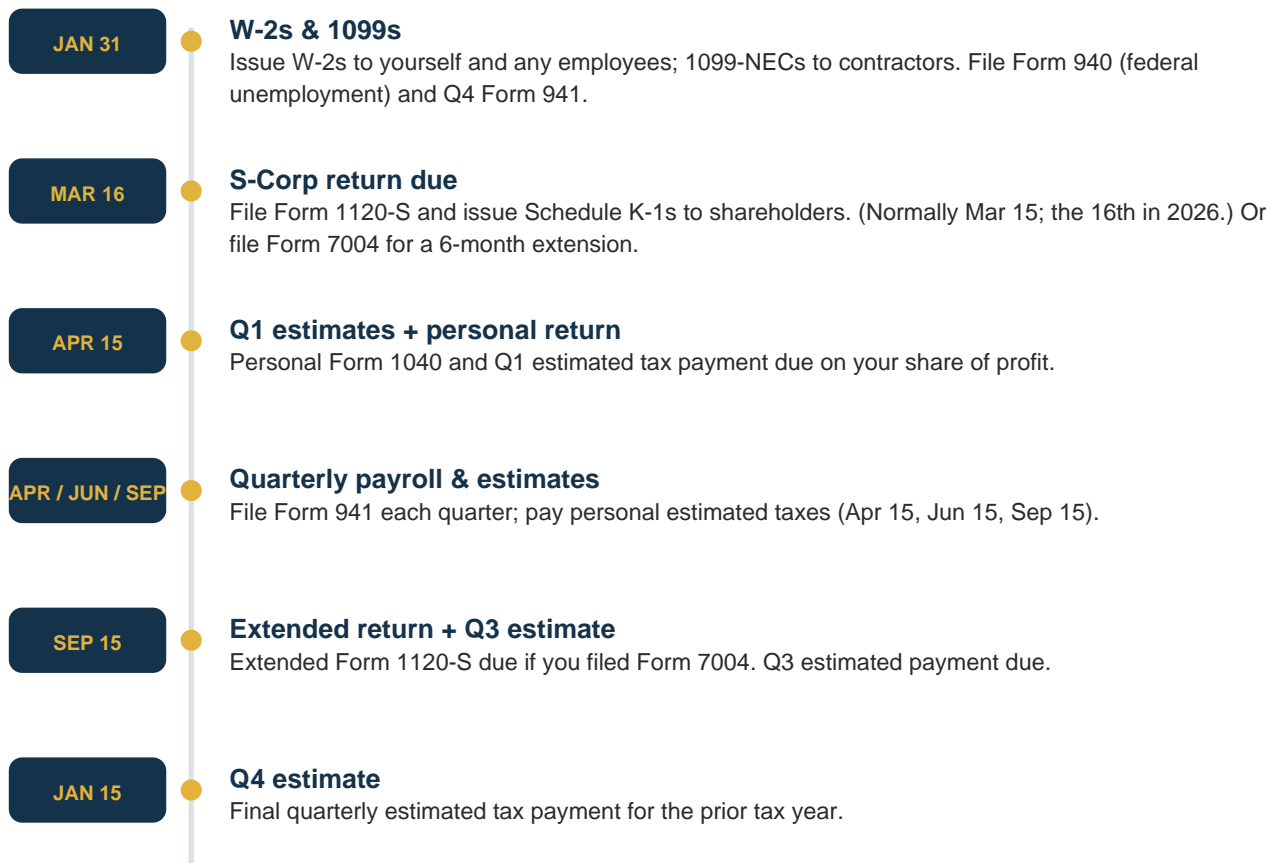
**A common starting framework.** Many advisors look at total profit and target a salary in a defensible range — often somewhere around **40–60%** of net profit for an active owner, then adjust based on the factors above and real market wage data. The key word is **documented**: we keep a written basis for the figure we choose, so it holds up if anyone ever asks.

### How we handle it for you

We prepare a reasonable-compensation analysis using market wage data for your role and region, document the rationale, and revisit it each year as your business changes. You get a salary number you can defend — and the confidence to take the rest as distributions.

## 06 YOUR COMPLIANCE CALENDAR

An S-corp runs on a rhythm of recurring deadlines. Miss the annual return and the penalty is **\$255 per shareholder, per month**, even if you owe no tax. Here's the year at a glance — we track these for you, but it helps to know the cadence.



### A NOTE ON THESE DATES

Dates shown are for calendar-year S-corps and shift when they fall on a weekend or holiday. California adds its own filing (Form 100S) and a minimum franchise tax — we manage both.

## 07 COSTLY MISTAKES TO AVOID

### ! **Skipping payroll**

Taking all profit as distributions with no salary is the fastest way to draw an IRS challenge — and reclassification with penalties.

### ! **Setting salary too low**

An unreasonably small salary relative to profit is a classic audit trigger. Document the number.

### ! **Mixing personal & business funds**

Paying personal expenses from the business account undermines your structure and your books.

### ! **Forgetting the entity still files**

An S-corp files Form 1120-S every year even with no income. Missing it stacks penalties fast.

### ! **Ignoring state rules**

California and many states have their own return and minimum tax. Federal compliance alone isn't enough.

### ! **Electing too early**

Electing before profits justify it means paying for payroll and filings without the offsetting savings.

## Let's find out if it's right for you.

We'll run your numbers, handle the election, and keep you compliant from day one.

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This guide is general education, not tax or legal advice, and reflects federal rules for the 2025 tax year (returns filed in 2026) plus California requirements. Thresholds, salary ranges, and the example figures are illustrative; your situation will differ. Please consult Milestone before acting.