How to Structure Your Business to Pay Less in Taxes

Choosing the right business structure isn't just about legal protection or operational flexibility. It also plays a significant role in how much you pay in taxes.

Sole Proprietorship

A sole proprietorship is the simplest form. You're the sole owner, and the business isn't a separate legal entity. That means all the income and expenses flow directly to your personal tax return. But here's the catch, you're responsible for self-employment taxes covering both the employer and employee portions of Social Security and Medicare, plus you might need to make quarterly estimated tax payments to stay on track.

Partnership

If you're in business with one or more people, a partnership structure can be a natural fit. A general partnership is relatively easy to form and doesn't pay income tax as a separate entity. Instead, the partnership files an information return and passes income deductions and credits down to each partner. Each partner then reports their share of income on their individual tax return. With some exceptions, partners also pay self-employment tax on their share of business income.

S Corporation

Considering an S corporation? This structure allows income, losses, deductions and credits to pass through to shareholders. Income passed through to shareholders and taxed at the shareholder level is not subject to self-employment tax. However, the IRS requires any shareholders that work for the company to receive a reasonable salary, which is subject to payroll taxes. S corporations can make distributions to their shareholders which are not taxable to the shareholders, as long as they have basis.

C Corporation

A C corporation is a separate tax paying entity, meaning it pays corporate income tax on its profits. If profits are distributed to shareholders as dividends, those are taxed again at the shareholders personal tax return. This double taxation can be a downside, but C corporations can offer benefits like easier access to capital through stock sales.

LLC

The LLC structure offers liability protection and flexibility. By default, a single member LLC is taxed like a sole proprietorship, while a multi-member LLC is taxed like a partnership. An LLC also has an option to be taxed as a C corporation or even an S corporation, if it makes additional elections and meets certain qualifications.

Your choice of business structure affects not only your legal responsibilities, but also your tax obligations. It's important to consider factors like the number of owners, the nature of your business and your financial goals.

Consulting with a tax professional can help you make the best decision for your specific situation.

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