GUIDE

C-Corp vs S-Corp, which one fits?

An S-Corp passes profit to its owners, who pay tax once at their own rates and save payroll tax on distributions. A C-Corp pays a flat 21% corporate tax, and owners pay again on dividends. Most small, owner-run businesses do better as S-Corps. Companies raising venture money usually choose C-Corps.

QUICK FACTS

- **C-Corp rate.** Flat 21% federal corporate tax
- **S-Corp.** Profit passes through to owners
- **Investors.** Venture investors usually require a C-Corp

How are C-Corps and S-Corps taxed?

A **C-Corp** is a separate taxpayer. It pays a flat 21% federal tax on its profit. When it pays dividends, shareholders pay tax again, usually at 15% or 20% plus the 3.8% net investment income tax at higher incomes. That's the "double tax".

An **S-Corp** doesn't pay federal income tax. Its profit passes through to the shareholders, who pay tax at their own rates. Owners who work in the business take a reasonable salary through payroll, and the rest comes out as distributions without Social Security and Medicare tax. Owners may also get the qualified business income deduction of up to 20%.

How do the numbers compare?

Say a company earns $200,000 of profit after paying its owner a $100,000 salary, and the owner wants all of it.

STEP	C-CORP	S-CORP
Entity-level federal tax	$42,000 (21%)	$0
Left to pay out	$158,000 as dividends	$200,000 as distributions
Owner's federal tax on the payout	Up to 23.8% (15% or 20%, plus 3.8% at higher incomes)	Income tax at the owner's rate, less the QBI deduction

General information, not tax advice for your situation.

The S-Corp usually wins when the owner takes the money out. The C-Corp can win when profit stays in the company to grow, because 21% may be lower than the owner's personal rate.

When does a C-Corp make sense?

- **You're raising venture capital.** Investors want preferred stock, which an S-Corp can't issue
- **You'll sell the company.** Qualified small business stock under Section 1202 can exclude a large part of the gain from tax if the requirements and holding period are met
- **You keep profits in the business.** Reinvested profit is taxed only at 21% until it's paid out
- **You have non-US or entity owners.** S-Corps can't have non-resident alien, partnership or corporate shareholders

When does an S-Corp make sense?

- You run the business and take most of the profit out each year
- Profit is high enough that the payroll tax saved beats the extra cost of payroll and a separate return
- All owners are US individuals and you're fine with one class of stock

Run your numbers in the S-Corp calculator, and read S-Corp vs LLC if you haven't formed yet. You can elect S-Corp status with Form 2553.

Common questions

Can I switch from a C-Corp to an S-Corp?
Yes, by filing Form 2553 if you meet the rules. Gains built up while you were a C-Corp can still be taxed if you sell assets within five years.

Is an LLC a C-Corp or S-Corp?
Neither by default. An LLC is taxed as a sole proprietorship or partnership unless it elects to be taxed as a C-Corp or an S-Corp.

Do C-Corps pay state tax?
Most states tax corporate income. Some also tax S-Corps at the entity level, and Texas charges franchise tax on both.

Which is better for a one-person business?
Usually an S-Corp, once profit is steady and high enough to justify payroll. A C-Corp mainly helps if you plan to keep profit in the company or sell it.

Want a plan for this year?

We run your numbers and show you the options. Book a free 30-minute call at eminenttax.com/contact or call (972) 347-4590.

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