



Case Study:
**Tax Optimization for a Healthcare
Independent Practitioner Operating an LLC
Without S-Corp Election**

Background

Client Profile:

- Independent healthcare practitioner (e.g., physical therapist, psychologist, or similar)
- Operates as a single-member LLC taxed as a disregarded entity (sole proprietorship)
- Annual gross revenue: \$650,000
- No S-Corp election currently made

Objective

To provide a comprehensive analysis of the benefits of electing S-Corp status for the LLC to minimize the practitioner's overall tax burden, along with recommended steps to make the election, and key takeaways.

Current Tax Situation (LLC Without S-Corp Election)

- The LLC is treated as a sole proprietorship for tax purposes.
- All business income flows directly onto Schedule C of the practitioner's personal Form 1040.
- Net income is subject to:
 - Ordinary income tax at the practitioner's marginal tax rate (likely high given \$650K revenue).
 - Self-employment (SE) tax of 15.3% on net earnings (up to Social Security wage base, plus 2.9% Medicare tax on all net earnings).
- No formal distinction between salary and distributions; all income is subject to SE tax.

Potential Benefits of Electing S-Corp Status

1. Reduction in Self-Employment Taxes

- As an S-Corp, the practitioner becomes an employee of the corporation and must pay themselves a "reasonable salary."
- The salary is subject to payroll taxes (Social Security and Medicare), but distributions of remaining profits are not subject to self-employment tax, only ordinary income tax.
- Example: If the practitioner pays themselves a reasonable salary of \$150,000, only that amount is subject to payroll taxes. The remaining profit (e.g., \$500,000) is distributed as dividends and avoids SE tax.
- This can result in substantial tax savings on the SE tax portion.

2. Potential Income Tax Savings

- While S-Corp income passes through to the individual's tax return, the reduction in SE tax can effectively lower total tax liability.
- Additionally, certain deductions and fringe benefits may be more accessible or advantageous in an S-Corp structure.

3. Enhanced Credibility and Formality

- Operating as an S-Corp may enhance professional credibility.
- Can facilitate retirement planning options such as a Solo 401(k) or SEP IRA with higher contribution limits based on salary.

Personalized Action Plan for LLC Owner Considering S-Corp Election

Profile Summary:

- Annual Revenue: \$650,000
- Annual Expenses: \$325,000
- Net Income Before Taxes: \$325,000 (Revenue - Expenses)
- Personal Tax Rate: 22%
- Self-Employment Tax Rate: 15.6% (includes Social Security and Medicare)

Step 1: Analyze Current Tax Situation (LLC as Sole Proprietor)

- Net income of \$325,000 flows directly to Schedule C.
- Subject to ordinary income tax at 22% and SE tax at 15.6%.
- Estimate total taxes paid under current structure.

Step 2: Determine Reasonable Salary for S-Corp Election

- Based on industry standards and workload, recommend reasonable salary = \$150,000.
- Salary subject to payroll taxes (15.6%).
- Remaining profit (\$325,000 - \$150,000 = \$175,000) distributed as dividends, not subject to SE tax.

Step 3: File IRS Form 2553 for S-Corp Election

- File by March 15 for the election to be effective for the current tax year.
- If missed, election applies next tax year.

Step 4: Set Up Payroll System

- Register for payroll taxes and withholdings.
- Pay yourself a salary of \$150,000 through payroll.
- Remit payroll taxes quarterly.

Step 5: Maintain Corporate Formalities

- Maintain separate bank accounts.
- Keep clear records of payroll and distributions.
- File Form 1120S annually.

Step 6: Monitor and Adjust

- Review salary annually to ensure it remains reasonable.
- Adjust distributions accordingly.

Detailed Financial Projection

Description	Current LLC (No S-Corp)	LLC with S-Corp Election
Revenue	\$650,000	\$650,000
Expenses	\$325,000	\$325,000
Net Income Before Taxes	\$325,000	\$325,000
Salary (Reasonable Compensation)	\$0	\$150,000
Profit Distributed (Dividends)	\$325,000	\$175,000

Tax Calculations

1. Current LLC (No S-Corp Election)

- Self-Employment Tax:
 $\$325,000 \times 15.6\% = \$50,700$
- Taxable Income After SE Tax Deduction:
SE tax deduction = $\$50,700 / 2 = \$25,350$
Adjusted taxable income = $\$325,000 - \$25,350 = \$299,650$
- Income Tax:
 $\$299,650 \times 22\% = \$65,923$
- Total Tax Liability:
SE tax + Income tax = $\$50,700 + \$65,923 = \$116,623$
- Net Income After Taxes:
 $\$325,000 - \$116,623 = \$208,377$

2. LLC with S-Corp Election

- Payroll Taxes on Salary:
 $\$150,000 \times 15.6\% = \$23,400$
- Taxable Income After Payroll Tax Deduction:
Payroll tax deduction = $\$23,400 / 2 = \$11,700$
Adjusted taxable income = $\$325,000 - \$11,700 = \$313,300$
- Income Tax:
 $\$313,300 \times 22\% = \$68,926$
- Total Tax Liability:
Payroll tax + Income tax = $\$23,400 + \$68,926 = \$92,326$
- Net Income After Taxes:
 $\$325,000 - \$92,326 = \$232,674$

Summary of Tax Savings

Description	Current LLC	LLC with S-Corp	Difference (Savings)
Total Tax Liability	\$116,623	\$92,326	\$24,297
Net Income After Taxes	\$208,377	\$232,674	+\$24,297

Key Notes

- The \$24,297 tax savings is primarily due to the reduction in self-employment tax by splitting income into salary and dividend distribution.
- The S-Corp owner must ensure the salary is reasonable to avoid IRS penalties.
- Additional administrative costs for payroll and tax filings are not included but are typically outweighed by tax savings.
- These calculations assume all income is taxable at the flat 22% rate; actual tax brackets and deductions could affect final results.

Final Recommendations

- Elect S-Corp status by filing Form 2553 promptly.
- Set up payroll and pay yourself a reasonable salary of \$150,000.
- Maintain compliance with payroll tax filings and corporate formalities.
- Consult regularly with a CPA to optimize salary and distributions annually.

Key Takeaways

- S-Corp election can significantly reduce self-employment taxes by splitting income into salary and distributions.
- The salary must be "reasonable" to avoid IRS scrutiny.
- Additional administrative responsibilities come with S-Corp status (payroll, filings).
- Timing of election filing is critical to maximize benefits in the current tax year.
- Consulting with a tax advisor is essential to tailor the approach to the practitioner's specific financial and professional situation.

Frequently Asked Questions (FAQs)

Q1: What is a "reasonable salary" for S-Corp owners?

A: It is the amount you would pay someone else to perform your job duties. Factors include industry standards, duties performed, hours worked, and business profitability.

Q2: Can I switch back to LLC tax treatment if I don't like the S-Corp election?

A: Yes, but there are timing restrictions and potential tax consequences. Generally, once you elect S-Corp status, you must wait five years to revoke without IRS consent.

Q3: Are there additional costs with S-Corp election?

A: Yes, including payroll service fees, increased accounting costs, and potential state-level fees.

Q4: Does S-Corp election affect state taxes?

A: It depends on the state. Some states recognize S-Corp status similarly to federal rules; others may impose additional taxes or fees.

Q5: What if my business income fluctuates?

A: You can adjust your salary annually, but it must remain reasonable for the services provided.

Conclusion

For a healthcare independent practitioner generating \$650,000 annually, electing S-Corp status for their LLC is a powerful tax planning strategy to reduce self-employment taxes and overall tax liability. While it introduces more complexity in compliance and payroll, the potential tax savings typically outweigh these costs. Careful planning and professional guidance are essential to maximize benefits and remain compliant.