LLC vs. S Corporation: Choosing the Right Entity for Your Business

Welcome everyone to another addition of the CK Small Business Focus. Today we are going to be analyzing which structure, LLC or S Corp, is best suited for your business.

Starting a new business comes with a long list of important decisions, and one of the most crucial is selecting the right entity type. The two most common structures for small businesses are the **Limited Liability Company (LLC)** and the **S Corporation (S Corp)**; each offering unique benefits and drawbacks. Understanding how these entities differ in terms of taxes, legal treatment, and administrative complexity can help you make the right decision as your business grows.

LLC: The Flexible Starting Point

An **LLC** is often the go-to legal structure for new entrepreneurs. It offers limited liability protection—meaning your personal assets are typically shielded from business debts and lawsuits—and allows for flexibility in ownership and income allocation.

For tax purposes, the IRS doesn't recognize an LLC as a distinct tax entity. Instead:

- A **Single-Member LLC (SMLLC)** is treated as a **disregarded entity**, with all activity reported on the owner's individual tax return (Schedule C).
- A **multi-member LLC** is taxed as a **partnership**, unless it elects to be treated as a corporation.

Pros of an LLC:

- **Simple tax filing** for SMLLCs (just report on your individual return).
- **Flexible ownership and income allocations**.
- **Low administrative burden**—ideal for startups and low-profit operations.

However, active owners of an LLC must pay **Self-Employment (SE) taxes** on the entire net income, which can be costly as the business grows.

S Corporation: The Strategic Upgrade

An **S Corporation** isn't a legal entity—it's a **tax election** that an LLC or C Corporation can make with the IRS. Once elected, it changes how the business is taxed and allows owners to reduce their SE tax burden by splitting income into salary and distributions.

Key Benefits:

- **Payroll tax savings**: Unlike LLCs, S Corp owners can pay themselves a "reasonable salary" and take the rest as distributions—exempt from SE tax.
- **Maximized Qualified Business Income (QBI) Deduction**: If structured correctly, you can take full advantage of the 20% QBI deduction introduced by the Tax Cuts and Jobs Act.
- **Lower audit risk**: S Corps file separate business tax returns, reducing audit visibility compared to Schedule C filings.

Important Considerations:

- **Increased compliance**: You'll need to file payroll, issue W-2s, and submit a separate business return.
- **Reasonable compensation** is required, and the IRS scrutinizes this closely.
- **State recognition varies**: Some states may not recognize the S Corp election and may impose additional tax filings.

When Should You Elect S Corp Status?

Electing S Corp status makes the most sense when your business is generating net income significantly above your reasonable salary. While "reasonable" is subjective, many practitioners suggest considering an S Corp once your annual income exceeds **$150,000**. The tax savings from reduced SE taxes can often outweigh the added compliance costs.

But not every business is ready for that transition. If your income is modest or irregular—or if you value operational flexibility and minimal paperwork—the LLC structure may still be the better fit.

Side-by-Side Comparison

Feature	**LLC (Default)**	**S Corporation**
Legal Structure	LLC	LLC or C Corp with S election
Tax Treatment	Sole Prop/Partnership	Separate S Corp tax return
SE Tax on Owner's Income	Yes	Only on salary
Payroll Requirement	Not Allowed	Required
QBI Deduction	May be limited	Optimized with payroll
Administrative Complexity	Low	Moderate to High

The Bottom Line

Your choice of business entity will shape your tax obligations, personal liability, and even your ability to raise funds. While most businesses start as LLCs for simplicity, making the S Corporation election can be a smart strategic move once you're generating higher profits.

Still unsure which path is right for you? The entity that suits your business today may not be the best option tomorrow. If you're a single-member LLC or a partnership looking to explore the tax benefits of electing S Corporation status, reach out to the experts at **CK** for tailored advice at www.craykaiser.com or call us at (630) 953-4900.