MONEY | INDUSTRY | PROFESSIONAL DEVELOPMENT

How and When to Pay Yourself From an Entity

Paying yourself from a sole proprietorship is straightforward and simple, but it can end up being very costly at tax time.

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As a new network marketer, you likely started off doing business in your own name in what's known as a "sole proprietorship." Paying yourself from a sole proprietorship is straightforward and simple, but it can end up being very costly at tax time. You basically use the money for whatever you need to and if you have a separate personal account from your sole proprietorship account you write checks from your business account to your personal account. At the end of the year, your accountant will look at what you paid yourself and add up expenses that may be 50% or 100% deductible to determine the part of your earnings that will be subject to employment tax (15.3% up to $113,700 in 2013) plus your state and federal tax obligations. In addition to paying the most in taxes, a sole proprietorship also places you in the highest audit category filing a Schedule C.

If you took the precaution of forming an entity for your networking marketing business (ideally an LLC taxed as an S corporation) the process of paying yourself works differently. The big picture to keep in mind is that the LLC is a separate legal entity from you and it must operate as such. Let's assume you have started your entity; the next step is to generate revenue to cover the overhead of the business. After that is it time to pay yourself and there are certain rules you must be aware of based upon the type of entity you formed. It may take a couple of months as revenues come in to be in a position to take money out of the entity for yourself.

Keep in mind, especially if you have a business partner, it is important to have up to date accounting records in place to determine if there is enough profit in the company to start making payouts to yourself and your partner. Many times there may be money in the bank account but a loss on the books because of obligations to cover startup capital, loans or

lines of credit. Let's review the basics of each structure and how you will be paid then get into more details:

TYPE OF ENTITY	PAYROLL	GUARANTEED PAYMENTS	DISTRIBUTIONS DIVIDENDS	OTHER
C Corporation	**X**		**X**	Dividends not deductible at the corporate level.
S Corporation	**X**		**X**	You must take a reasonable salary. Distributions are not subject to 15.3% employment taxes.
Single Member LLC - Disregarded			**X**	Subject to 15.3% employment taxes.
LLC Taxed as S Corporation				Same as S corp.
LLC Taxed as C Corporation	**X**		**X**	Same as C corp.

LLC Taxed as Partnership		**X**	**X**	Guaranteed payments to the manager are subject to 15.3% employment taxes. Distributions are also subject to 15.3% if the member is actively involved. There is NO payroll to partners in an LLC taxed as partnership,

Single member LLC disregarded for tax purposes: If you are the owner and the LLC is operating an active business, when you pay yourself you will write a check from the LLC checking account to your personal account. In the memo write the word “distribution.” Since the LLC is disregarded for tax purposes with earned income, all profits and losses will show up on schedule C, just as with a sole proprietorship. All earned income is subject to payroll taxes of 15.3% up to $113,700 in 2013. Any amount above that limit is subject the 2.9% Medicare taxes. If your single member LLC owns real estate, rents are not subject to employment taxes and sale of the property is accounted as either short or long term capital gains.

S Corporation or LLC taxed as an S corporation: The key point is to pay yourself a reasonable salary and take the rest as distributions. It may be difficult to determine what salary to pay yourself because it may take 3-6 months for income to become consistent in your business. Again, the first step is to generate enough revenue to pay the monthly expenses of the business. If that does not happen, you may have to “put” more money into the business from yourself personally. That may come in the form of

a personal loan to the business (this is after capitalization when you started).

Let's assume you just started your LLC taxed as an S corporation in August and you expect to generate $100K of gross revenue by December 31st (the tax year end for an S corporation). Let's assume after expenses you expect a gross profit of $60K. That means there should be $60K left in which to pay yourself. A portion of that will be payroll (you are an employee to the S corporation) and the rest in distributions which are NOT subject to the 15.3% employment tax. It might be tempting to only take $5K as payroll and $55K as distributions to reduce the employment tax but that is NOT recommended. The IRS expects a reasonable salary and S corporations are targeted for audits especially if there is no salary.

Here is how this typically unfolds as your entity is up and running; the entity may not have enough for a payroll so you may have small distributions for a few months of $1,000 here and there. For distributions you will write a check from the LLC to your personal account and write "distribution" in the memo. If you get too busy and forget about the end of the year on December 31st it may also be possible that you "forget" to do any payroll in the current tax year. That's a problem because there are certain rules and taxes that have to be handled when you have an employee, even if you're the only one. Yes, in an LLC taxed as an S corporation YOU are the employee. Below is an overview chart of payroll issues you should be aware of. NCP clients have access to a complete webinar that covers all these concerns under "Fast Start Training/Payroll Fundamentals in the NCP member's area.

Employee Responsibilities:

- New Hire Reporting (in Nevada you must report the employee in the first 20 days of working; if not the business owner may be responsible for things like child support payments! Yes, you do need to report yourself as the owner/employee when you first start payroll).

- Classification of employees vs. 1099 independent contractors (you must know from the start if someone you hire is an employee or independent contractor).
    - Who is on payroll
    - Worker's Compensation Insurance (mandated by the states).

- Department of Labor Compliance
- Record Keeping
- Payroll Processing
- Termination

C Corporation. A C Corporation has separate tax brackets. It is NOT a flow-through entity. The C Corporation will file a federal tax return; the 1120. On any profits left in the corporation, federal and (in most cases) state corporate taxes will be paid. If you are an officer of the corporation and also a statutory employee, any payroll to yourself will be an expense to the C Corporation and lower the profits of the C Corporation which in turn will lower the taxes to be paid by the C Corporation. You can pay dividends from the C Corporation to yourself and they are not subject to the 15.3% employment taxes BUT they will NOT reduce the profits of the C Corporation! It is recommended that once your revenues are consistent that you get on a regular payroll with the C Corporation and pay yourself every two weeks like most companies or twice a month. You want to avoid as the owner taking money from the corporation without payroll and figuring out later if it was a dividend or a personal loan that has to be paid back.

LLC taxed as a partnership. The most important point is that as a partner in an LLC taxed as partnership there is NO payroll! You are NOT a partner AND an employee. You might be thinking then, who am I? There is something called a guaranteed payment which is similar to payroll in that it is subject to the same 15.3% employment taxes. The manager of the LLC who runs day to day functions may be on a monthly guaranteed payment. That is paid as a first priority; even if the partnership is losing money, provided there is enough money to make the guaranteed payments. To make a guaranteed payment write a check from the LLC to you personally (assuming you are the manager) and in the memo write, “guaranteed payment”. Once guaranteed payments are made there may also be distributions in profits. Distributions in profits to partners in an LLC taxed as a partnership if actively involved are also subject to the 15.3% employment taxes. If the member is passive only those distributions are not subject to the 15.3% employment taxes. There are more details about passive versus active on the IRS.gov web site. If the LLC taxed as a partnership is owned by an LLC taxed as an S Corporation then the profits will flow through to the LLC taxed as an S Corporation

and now there would be a reasonable salary from the S corporation and the rest as distributions which are not subject to employment taxes.

In summary, the most important item is to have your accounting records in place from the start of your business. You must have a budget, cash flow and your chart of accounts up and running. If you need help in this area, NCP offers a complete tax and bookkeeping coaching program. We recommend you use QuickBooks® to manage your business and personal budget. Once you have accurate numbers you will be in a better position to determine when any type of payroll or distributions may start. If you are getting ready for payroll, even for yourself, there are so many state and federal rules that we never recommend trying to do this on your own. Because of the risk, most CPA firms do not want to do payroll. Our best recommendation is to work with ADP, the largest payroll processing company in the U.S. You may call our local representatives here in Las Vegas (even if you are doing payroll in another state) and they will give you our special rate: 702-650-6209 and ask for Sharon Mastrio or another payroll professional. Let them know you were referred by Nevada Corporate Planners to get the special discount rate.

As a *Network Marketing Magazine* subscriber, you're entitled to receive a free consultation when you call Nevada Corporate Planners, Inc. at 1-888-627-7007. We'll answer your questions and walk you through all the fees and services. Go to www.IncorporateWithConfidence.com to learn what how to choose the entity that's best for your business, protect your assets and avoid costly mistakes. You can download our valuable free business training and receive key strategies to keep and protect more of your network marketing earnings.

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Scott Letourneau is *"The Expert on Establishing and Positioning Network Marketing Companies for Maximum Profit!"*

Worldwide **successful entrepreneurs turn to *only one person*** when they want to establish their **company in the United States.** They want the one person who they know can deliver a truly

turnkey experience to position themselves for profits and success. That person is Scott Letourneau!

Scott is the prominent entrepreneur and CEO who founded Nevada Corporate Planners, Inc. in 1997. He also founded the complementary Fast Business Credit, Inc. in 2003, again with great success.

In addition, Scott is a busy lecturer, consultant and author, who is recognized worldwide for helping entrepreneurs get their businesses off to a fast start in the United States.

You will learn from Scott's diverse expertise and complete turnkey business solution, along with his comprehensive and ever-growing list of powerful business resources. These are the very elements that have **allowed his 5,000+ clients both domestic and abroad** to incorporate their business with confidence, ***"propelling their business on a fast track to profits!"***

Scott is the *only* speaker offering a solution to help clients accomplish two goals: how to grow net worth and profits in the shortest period of time *and* how to **sustain and protect your net worth as it builds and accumulates.**

He is **recommended by top professionals** such as **Sandy Botkin**, a top Attorney/CPA; Attorney **Dr. Arnold Goldstein**; top Internet marketers **Tom Hua, Brett McFall**, and **Stephen Pierce**; and marketing expert **Jay Abraham** and other top CEOs and professionals throughout the U.S. and internationally. Leading entrepreneurs throughout the world laud him as the foremost expert on not only incorporating businesses, but also helping owners get access to capital and other invaluable business tools. Scott has a BA in Finance, a Masters Practitioners Degree in NLP (Neuro Linguist Programming, the study of patterns of success) and is the author of *"The Insiders Guide to Incorporating Your Business and Protecting Your Assets!"* He is also a contributing author for the new book from *Entrepreneur Magazine's* Start Up series; *"Start Your Own Information Marketing Business – Your Step-by-Step Guide to Success."*

He has appeared on **CNN Headlines News with Pat Summerall's Success Stories**, and has been interviewed by various radio and TV stations throughout North America, eager to tap into his expertise and experience.

Scott understands the **energy and passion required** to balance a successful and growing **business along with a healthy and thriving family life**. He has been in **business for over 12 years and married for 13 years** to his beautiful wife De Ann, an amazing classical violinist, and is the proud father of three beautiful girls, Gracie, Rosie and Faith. His family and offices are headquartered in Las Vegas, Nevada, where he has made his home for the last 15 years.