# Choice of business entity – a capstone tax project

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**ABSTRACT**

This choice of business entity project integrates tax rules for individuals and business entities for a comprehensive analysis that applies several of the American Institute of Certified Public Accountants Pre-certification Core Competencies including measurement analysis and interpretation and technology and tools. Students are provided a scenario of a group of professionals who are setting up their own consulting practice and require advice regarding choice of business entity. Students compare limited liability companies, S corporations, and personal service corporations. By including compensation information for the consultants, who are all currently employees, the project integrates individual taxation with business entities taxation and necessitates students to include an evaluation and comparison of after-tax cash flows received by the individual consultants for the different options. In addition to income tax, students are required to calculate employment taxes consisting of social security taxes and Medicare taxes. The project is an effective capstone tax project for a second tax course in a two-course sequence where the first course focuses on individual taxation and the second course focuses on business entities taxation or the project can be used in graduate tax class covering flow through entities. It helps integrate material from multiple topics from both individual and business entities taxation.

Keywords: tax planning, business entity choice, individual tax formula, after-tax cash flow, limited liability company, S corporation, personal service corporation

## INTRODUCTION

This case provides a scenario of a group of professionals who are setting up their own consulting practice and require advice regarding choice of business entity. Students compare limited liability companies (LLCs), S corporations, and personal service corporations (PSCs). By including compensation information for the consultants, who are all currently employees, the project integrates individual taxation with business entities taxation and necessitates students to include an evaluation and comparison of after-tax cash flows received by the individual consultants for the different options. The project requires an extensive use of Excel to compare the options. The project is an effective capstone tax project.

A number of the American Institute of Certified Public Accountants (AICPA) Pre-certification Core Competencies (AICPA, 2018) are addressed with this project. Creation of the Excel workbook is an excellent opportunity for the students to utilize relevant technology to analyze data. By creating the workbook, the students also apply the accounting competencies of reporting and measurement analysis and interpretation. Additionally, the students use professional competencies of decision-making and project management.

## BACKGROUND

This is a fictitious case. All information contained herein was fabricated by the author. Any similarity contained herein to actual persons, businesses, events, etc. is purely coincidental and is the responsibility of the author. Please contact the case author directly with any concerns.

However, aspects have been informed by actual consulting firms' restructurings. For example, although start up firms frequently lose money, professionals spinning off from a parent company and bringing clients with them are not a typical startup company and can be profitable from day one. In the case, the students are provided the example of Accenture, a global management consulting company, which was originally the business and technology consulting division of Arthur Andersen. In 1989, Arthur Andersen then set up a separate consulting unit named Andersen Consulting. In 2000, Andersen Consulting finalized separating from Arthur Andersen and became Accenture (Leonhardt, 2000). An additional example is mentioned in class based on the author's own experience where an employee benefit consulting firm sold themselves to a large human resources firm. However, a few years later, the three founding partners negotiated to buy the consulting business back and at the same time offered some key employees small ownership interests as an enticement for them to leave the large firm. Additionally, the assumption that all profits are distributed to owners might seem unrealistic, but is not an unusual decision for closely-held businesses with owners who work in the business, providing significant personal services, including accounting, law, medical, and consulting. For example, due to concerns about double-taxation "most personal service corporations distribute substantially all their income as wages to the employee/shareholders" (Koppel, 2016).

Although the case also makes some simplifying assumptions, it still requires applying a number of tax rules using Excel formulas. For example, for the current version, students are required to calculate tax using a LOOKUP table. Additionally, for child tax credit phase out, additional Medicare tax, and the qualified business income (QBI) deduction, students have to write formulas that first assess whether the taxpayer is subject to the item and then, if subject to, complete the calculation. In addition to income tax, students are required to calculate employment taxes consisting of social security taxes and Medicare taxes (FICA taxes). To appropriately calculated social security tax, students also have to write a formula to determine whether FICA compensation exceed the social security wage base.

This case fits well when covering flow-through entities and provides a good illustration of how owners working in a business have different tax outcomes depending on business entity chosen. It integrates tax rules for business entities with those of individuals. It illustrates a frequent motivation for using an S corporation rather than an LLC taxed as a partnership when the owners are working in the business. In recent years, when the case is assigned, there has been a class lecture summarizing the similarities and differences among business entities and then discussing the taxation of payment for services, focusing on the taxation of payment to owners who work in the business.

## CASE MATERIALS

### Case Background

Eight individuals (the Group) are asking for your advice concerning what form of business entity they should use for a consulting business they are starting. All of the individuals are currently employees at a large consulting firm. Three of the individuals will own 30% each of the new entity and five of the individuals will own 2% each. All the individuals own sufficient liquid assets to make required capital contributions but the majority of their assets are houses, autos, retirement savings, college funds, etc.. Therefore, they want to limit their liability with respect to any business venture.

The Group is bringing their clients with them from their existing employer (a legal agreement is already negotiated) so they have a good estimate of future revenues and expenses and expect to be profitable.[1] Almost all of their revenue comes from the performance of services. Estimates of revenues and expenses from the new consulting firm indicate that there would be free cash flow for the group to receive over and above their current compensation. The additional amounts can be paid as additional compensation (salary or bonus), or as distributions or dividends. The estimated amount available varies depending on whether the entity is required to pay a portion of FICA taxes for the Group and whether the entity pays any income tax. For example, an owner in a personal service corporation (PSC) is treated as an employee so the company pays the employer's share of FICA taxes, but an owner in a limited liability company (LLC) taxed as a partnership is treated as self-employed and pays all of the FICA taxes. Therefore, a PSC has less free cash flow at the entity level than an LLC but an LLC owner will pay higher amounts of FICA taxes out of amounts received from the company. In Table 1 are the free cash flows by entity type and by how the extra cash is paid out. These amounts are after employer paid FICA taxes but before any other entity level taxes.

[1] For example, Accenture, a global management consulting company, was originally the business and technology consulting division of Arthur Andersen. In 1989, Arthur Andersen then set up a separate consulting unit named Andersen Consulting. In 2000, Andersen Consulting finalized separating from Arthur Andersen and became Accenture (Leonhardt, 2000).

| Table 1 | |
|---|---|
| **Free Cash Flow by Entity Type After Any Employer Paid FICA (But Before Any Entity Level Tax)** | |
| Limited Liability Company (LLC) | $700,000 |
| S Corporation – if extra cash treated as compensation | $590,000 |
| S Corporation – if extra cash treated as a distribution | $599,000 |
| Personal Service Corporation (PSC) – if extra cash treated as compensation | $590,000 |
| Personal Service Corporation (PSC) – if extra cash treated as a dividend | $599,000 |

The Group currently proposes to receive the additional amounts pro-rata. Additionally, the Group expresses that they do not want to be worse off financially (in terms of after-tax cash flow) after forming the consulting business. The five individuals who are proposed to own 2% each will not have much voting power but provide essential client services and they have all indicated they will not join the Group if the proposal is not to their liking. As a closely held consulting firm where all the owners work in the business, the owners will leave sufficient cash in the business to be successful but are also interested in maximizing individual wealth.

In addition to cash compensation, the firm currently employing the Group offers a range of benefits that the Group elects to use. These benefits include: a cafeteria plan which allows benefits to be paid for with before tax dollars; a flexible spending plan which allows medical expenses to be paid with before tax dollars; and a 401(k) plan (without any employer matching) which allows contributions to be paid with before tax dollars. Employee contributions for these benefits are in Table 2. The current employer pays 50% of the cost of health insurance (i.e. employee pays $7,200 and employer pays $7,200).

**Table 2**

**Data on Current Annual Compensation of the Individuals in the Group**

| | compensation including before tax amounts | medical insurance paid by employee (before tax) | medical insurance paid by employer | medical flexible spending account paid (before tax) | 401(k) plan paid (before tax) |
|---|---|---|---|---|---|
| 3 individuals | $330,000 each | $7,200 each | $7,200 each | $2,400 each | $19,500 each |
| 5 individuals | $225,000 each | $7,200 each | $7,200 each | $2,400 each | $19,500 each |
| Total | $2,115,000 | $57,600 | $57,600 | $19,200 | $156,000 |

**Required**

To prepare to discuss alternatives with the Group, after-tax cash flow comparisons are needed. Therefore, prepare an Excel workbook that calculates and compares after-tax cash flows for the individuals who are:

1. an employee
2. a shareholder in a PSC
    a. with all extra cash paid as compensation
    b. with all extra cash paid as a dividend

3. a shareholder in an S corporation
    a. with all extra cash paid as compensation
    b. with all extra cash paid as a distribution (assume distribution = allocated income)
4. a member of an LLC taxed as a partnership

Some assumptions that can be made for worksheet calculations are:

1. All of the individuals are married filing joint returns and have 2 dependent children who are <18 years old and >6 years old.
2. They all use the standard deduction.
3. Use the 2021 tax rules.
4. Assume dividends are taxed at 15% (distributions from partnerships & S corporations are not dividends)
5. Ignore state tax effects.
6. Their only income is from their consulting activity (e.g., spouse does not work; they have no interest income, etc.).
7. They have medical expenses equal to their flexible spending account amounts. Their medical insurance costs $14,400 per year no matter which entity is chosen.
8. They contribute $19,500 to a retirement plan, even if the entity chosen allows a higher contribution.
9. For an LLC taxed as a partnership, members pay self-employment tax on all allocated income, not just guaranteed payments and the LLC pays $7,200 toward each member's health insurance.
10. Since owners in LLCs and S corporations pay tax on allocated income not distributions, additional cash amounts available for distribution will be assumed to equal allocated income for an LLC and an S corporation.

These assumptions simplify the calculations but can be relaxed to explore the effects of different scenarios.

Make your Excel workbook as flexible as possible. Enter data given in this handout only one time in a separate data worksheet. Do not do any calculations in the data worksheet. Then have a separate worksheet for each scenario (employee, LLC owner, etc.) Set up your worksheet calculations and cell references so that any change in assumptions is analyzed by only changing a few cells. For example, use a lookup function to calculate tax on taxable income and an IF statement to determine whether additional Medicare tax applies. Use the tax tables for 2021. Worksheet only has to work for 1 filing status, i.e., Married filing joint.

**Optional Additional Requirement**

After preparing an Excel workbook to compare after-tax cash flows, students can be asked to prepare a report that incorporates the findings concerning after-tax cash flows and explores other considerations for business entity choice. The report would discuss what form of business entity the student would advise these individuals to set up, incorporating the results from the workbook. Discuss the business entity forms considered and the reasons for eliminating ones not chosen. The reasons should go beyond tax considerations. If the entity form chosen allows a choice for tax purposes (check-the-box) indicate what tax choice is recommended and why. If S corporations or personal service corporation (PSC) is chosen, a discussion of reasonable compensation is required. Some consideration of state level issues would be insightful. Additionally, are there any recommended changes to the above proposal that would be improvements? An outline of the report follows:

1. Start the report by summarizing the facts.
2. Discuss the alternative entity types considered (LLC, S corporation, and PSC) and compare and contrast these entity types (legal differences, tax differences, etc.)
3. Summarize and discuss the numerical analysis from your workbook. Attach all of the worksheets to the report but also pull the most relevant data into the report, using tables, charts, and graphs.
4. Discuss the specific entity you recommend and why
    a. If you are choosing an LLC taxed as a partnership, you must discuss the treatment of the owners' distributive shares as self-employment income. For example, review Renkemeyer, Campbell & Weaver, LLP v. Commissioner, 136 T.C. No. 7 (2011).
    b. If you are choosing an S corporation or a personal service corporation (PSC), you must discuss reasonable compensation.
        i. Examples of court cases for an S corporation would be:
            1. Watson, David E., P.C. v. United States of America, 668 F3d 1008 (8th Cir., 2012).
            2. Joly, J. Michael v. Commissioner, TC Memo 1998-361 (1998).
            3. Radtke, Joseph v. United States of America, 895 F2d 1196 (7th Cir. 1990).
        ii. Examples of court cases for a PSC would be:
            1. Pediatric Surgical Associates, P.C. v. Commissioner, TC Memo 2001-81 (2001).
            2. Curtis, Thomas A., M.D., Inc. v. Commissioner, TC Memo 1994-15 (1994).
    c. Discuss any proposed changes or improvements you recommend.
    d. Discuss any state tax issues that are insightful.
5. At the end, summarize and conclude.

**IMPLEMENTATION GUIDANCE**

For a number of years, this case has been used multiple times with graduate students in either a business entities taxation class or a flow-through entities taxation class. All students had completed a prior tax course, focusing on individual taxation, as an undergraduate student. The project is used as a capstone assignment that pulls together material learned in multiple tax classes.

The case materials can be modified to provide less information if the professor prefers. How much information to provide depends on the previous coursework completed by the students taking the class and whether the students are completing a tax specialization. If students taking the class have completed multiple graduate level tax classes and / or are completing tax specialization in their Masters' program, then less information could be provided. However, this case has primarily been used in classes where any graduate student might be enrolled and the only prerequisite is one undergraduate tax class, focusing on individuals. Therefore, for example, if a written report is required, then the report instructions include some specific court cases to consider because some students in the class have not had any tax research training.

If a report is required, it is preferable to split the project into two parts and have the workbook completed, reviewed, and graded prior to the report due date. There are two reasons this works well. First, students often spend a lot of time with the workbook and then run out of time so the report becomes very short and lacking in critical thinking. Also, if the workbook has an earlier due date, students who wait to the last minute to do their workbook will have it reviewed and can correct errors prior to writing a report. Therefore, their report is not based on flawed analyses.

In recent years, the workbooks have been reviewed and graded using electronic submission via email. The initial project submission is reviewed, revised based on comments received, and then resubmitted. This process of revise and resubmit continues until the workbook is correct. It can be time consuming but is an excellent opportunity for students to hone their Excel skills. A student with good Excel skills and good understanding of the material might require two to three rounds of review and 15 to 30 minutes of review time. However, at the other end of the spectrum, student workbook review can encompass over an hour of faculty time per student for the students who have weak Excel skills and weak understanding. Similar to how much information to provide in the instructions, the time commitment for reviewing workbooks depends on how many tax classes students have previously completed and whether the students are completing a tax specialization.

The project requires multiple weeks to complete, longer if a report is required. How quickly the students can complete it does depend on what material has been already covered in lecture. It does require an understanding of the taxation of LLCs, S Corporations, and PSCs. The students might also need a review of the individual tax formula and the taxation of compensation and benefits, depending on the coverage of these topics in the student's undergraduate tax class, which can include completing some or all of the calculation of after-tax cash flow as an employee. Three to four weeks is the minimum time to allow for the project. Since it is used as a capstone project, additional time to understand the material is better. Assigning it early in the second half of the semester is the best timing.

Preparation of the workbook can involve a faculty time commitment if the faculty member assigning the project helps students with their workbooks prior to final grading. The time commitment will vary depending on the workbook skills of the students completing the project. There are a number of simplifying assumptions allowed and these make the calculations on the workbook a little easier. Providing an amount of extra cash that takes into account employer paid FICA taxes for each type of entity also simplifies some calculations. An alternative is to indicate the extra cash is the same for all entity types but the amount would need to be reduced by any FICA taxes paid by the entity. It is possible to have the students submit the workbooks electronically for both preliminary and final review. It can work well for the professor to review multiple iterations and provide comments as it provides students experience with responding to feedback. Having to address comments is likely to occur in a work setting and most education does not provide students that experience. The project can be completed individually or in groups, depending on faculty preference and the student population characteristics (i.e., groups might be more difficult to implement with a part time night program or an online program).

## TEACHING NOTES

The current solution uses the 2021 tax rules but the workbook is designed so that future years' changes are easy to incorporate.[2] Similarly, other amounts given in the project such as current compensation and extra cash available can be changed, and the workbook automatically updates. Table 1 (Appendix) shows the data worksheet and numbers in boxes that are outlined can be changed and the changes will be carried through the entire workbook. For example, to update to current tax law, change the amount for the married filing joint standard deduction, phase out thresholds for child tax credit and QBI deduction, the taxable income amounts for the married filing joint tax brackets, and the social security ceiling amount. The data worksheet still includes data for exemptions although the amount is currently 0 because exemptions have not been permanently deleted and are scheduled to return in 2026. Aspects of the case can also be changed including number of owners and percentage owned, as long as the total ownership adds up to 100%. For the S corporation analysis owning less than or equal to 2% ownership versus greater than 2% results in different treatment for tax purposes so having owners in each category provides more challenging calculations for the students. Additionally, can change the amount of current compensation, cost of medical insurance (both employee and employer share), amount contributed to medical flexible spending, amount contributed to a retirement plan, and amount of additional cash available and the worksheets will all be updated.

As seen in Table 2 (Appendix), the first calculation is the current after-tax cash flow as an employee to have a baseline for comparing the alternatives. Some semesters this calculation is completed as a homework exercise prior to starting the project to provide the students a starting point, including understanding that employee paid medical insurance, flexible spending contributions, and retirement contributions are not subject to federal income tax but when calculating FICA taxes, retirement contributions are taxable. The calculations also require students to consider whether the individual is subject to additional Medicare tax or phase out of child tax credit. It works best for students to finalize the employee calculation before proceeding with the rest of the project so students have a good starting template for the other worksheets.

Next, the students are required to calculate after-tax cash flows if the Group chooses to be a PSC, an S corporation, or an LLC. There are many different alternatives depending on entity type and treatment of extra cash and the students complete five alternatives (one for LLC and two each for S corporation and PSC).

The recommended first analyses for the students to complete is a Personal Service Corporation (PSC). After the project had been used several times, this entity type was added to the project because some students would decide to suggest a C corporation option. Since PSC rules are not covered in any depth in most textbooks, the students suggesting a C corporation would not use the PSC rules. Therefore, the PSC was added as an entity to consider, and a short lecture on the PSC rules and requirements was incorporated into the class materials. With a PSC, the extra cash can be either additional compensation or distributed as a dividend. Paying the extra cash as compensation is tax deductible by the entity and reduces the entity's taxable income but paying the extra cash as dividends results in taxable income at the entity level. At the individual level, compensation paid to a PSC owner is treated the same as any other employee and is subject to both FICA and Federal income tax. It should also be noted that owners of PSCs

[2] Email jrlivingstone@wcu.edu for copy of the Excel workbook.

do not qualify for the qualified business income deduction since the entity is not a flow-through entity. As seen in Table 3 (Appendix), it is very easy to modify the employee worksheet to analyze PSC with extra cash as compensation.

However, with a PSC paying dividends, the complication is that entity level taxable income is taxed at 21%. Paying the extra cash as dividends results in taxable income at the entity level and the entity will have pay tax out of the extra cash before paying dividends. However, a dividend is only subject to a 15% federal income tax. As seen in Table 4 (Appendix), when distributing extra cash from a PSC as dividends, entity level tax has to be calculated first, and shareholders can only be distributed the extra cash after entity taxes are paid. Dividends are not compensation and, therefore, not subject to FICA taxes. Both taxable compensation and dividends are included in AGI and taxable income but then the taxable income has to be split into taxable income taxed at preferential rates (dividends) and taxable income taxed at ordinary rates to then calculate the related tax amounts.

Students are recommended to complete the S corporation analyses after the PSC analyses. For the S corporation analyses, the ownership levels are specifically at 2% and above 2% to illustrate the difference in treatment of compensation between the two ownership levels. A 2% owner is allowed to be treated as an employee for all benefits. However, a greater-than-2% owner is taxed on employer provided health insurance, not allowed to pay for employee health insurance on a before tax basis, and not allowed flexible spending accounts. However, a greater-than-2% owner is allowed a self-employed health insurance deduction. A greater-than-2% owner is allowed a retirement contribution to be withheld from compensation on a before tax basis.

For an S corporation, the analysis requires the extra cash to be treated as compensation or a distribution (assumed equal to allocated income). As seen in Table 5 (Appendix), if the extra cash is treated as additional compensation, then the extra cash is subject to both FICA taxes and federal income taxes. However, as seen in Table 6 (Appendix), if treated as allocated income, the amount is not subject to FICA taxes; only Federal income taxes.

For the S corporation, students are also required to consider whether the individuals qualify for a QBI deduction. The consulting business would be a specified service business so the 30% owner's income would always exceed the threshold and would not be allowed a deduction. When the extra cash is paid as compensation there is no qualified business income so the QBI deduction is 0, but when the extra cash is paid as a distribution then the allocated income is QBI and the QBI deduction would be 20% of the allocated income.

Additionally, if a written report is required, for both an S corporation and a PSC, the students are required to discuss reasonable compensation. It is important to understand that if a PSC's extra cash paid to owner-employees is all in the form of compensation then the owners might be receiving compensation that could be considered too high. Alternatively, if an S corporation tries paying employee-shareholders very low amounts of compensation to avoid employment taxes, the compensation could be considered too low.

Students are recommended to complete the LLC analysis last as it is more complicated. LLC owners cannot be treated as employees so amounts equivalent to current compensation will be paid as guaranteed payments. The guaranteed payments and also entity-paid health insurance (considered a guaranteed payment) are subject to self-employment tax. Self-employment tax is FICA taxes (social security tax and Medicare tax) paid by a self-employed individual. Students are also instructed to assume that allocated income is subject to self-employment tax. If a write up is required they are expected to discuss this issue. At a minimum, the students need to discuss Renkemeyer (2011), which concluded that lawyers who were members of a limited liability partnership (LLP) would be subject to self-employment tax on their distributive shares of income. As a self-employed individual, an LLC member, is allowed no before tax benefits when calculating self-employment earnings. FICA taxes are paid on net earnings from self-employment which are 92.35% of self-employment earnings. However, members of an LLC are allowed deductions when calculating AGI for the employer-equivalent portion of self-employment tax, 100% of medical insurance payments, and retirement savings contributions. The LLC results are shown in Table 7 (appendix).

Additionally for the LLC, students have to consider the QBI deduction. Similar to the S corporation with allocated income, the consulting business would be a specified service business so the 30% owner's income would always exceed the threshold and would not be allowed a deduction. Different from the S corporation with allocated income, the LLC members have to pay FICA taxes on the allocated income so the allocated income is reduced by the employer-equivalent portion of self-employment tax paid on the allocated income when calculating QBI.

As seen in Table 8 (Appendix), finally, the students also have to provide a schedule summarizing the end results of the different of entity choices and alternatives considered. Overall, this project students have to make extensive use of workbook technology, including decision modeling. The project also requires students to use higher-order thinking such as problem solving, decision-making, and critical thinking.

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## APPENDIX

**Table 1**
**Choice of Business Entity Analysis**
**Data for Analysis**

| | | | | | | |
|---|---|---|---|---|---|---|
| Tax Year Used | 2021 | | | | | Indicates amounts that can be changed |
| | | | total | | | |
| Number of owners | 3 | 5 | 8 | | | Enter the number of owners |
| Proposed percentage of ownership | 30% | 2% | 100% | | | Enter the percentage owned by each owner (total ownership must equal 100%) |
| Current compensation | 330,000 | 225,000 | | | 2,115,000 | Enter the current compensation received |
| Medical insurance paid by employee | 7,200 | 7,200 | | | 57,600 | Enter the medical insurance amount paid by employee |
| Medical insurance paid by employer | 7,200 | 7,200 | | | 57,600 | Enter the medical insurance amount paid by employer |
| Medical flexible spending account | 2,400 | 2,400 | | | 19,200 | Enter the medical flexible spending account contribution |
| Retirement plan contribution | 19,500 | 19,500 | | | 156,000 | Enter the retirement plan contribution |
| Married - joint - standard deduction | 25,100 | 25,100 | | | | Enter the standard deduction for a married filing joint couple |
| Exemption | 0 | 0 | 4 | 0 | | Enter the number of exemptions and the amount allowed per exemption (currently 0) |
| QBI deduction threshold | 329,800 | 429,800 | | | | |
| QBI deduction percentage | 20% | | | | | |
| Child tax credit | | | 2 | 2,000 | | Enter the number of eligible children <18 years old and >6 years old and the amount allowed per child |
| Child tax credit threshold for m-joint | 400,000 | | | | | Enter the threshold for the phase out for a married filing joint couple |
| For child tax credit phase-out formula | 1,000 | 50 | | | | |

**Table 1**
**Choice of Business Entity Analysis**
**Data for Analysis**

| | LLC | S corp & PSC - comp | S corp - distrib & PSC - div | |
|---|---|---|---|---|
| Additional cash available | 700,000 | 590,000 | 599,000 | Enter the amount of additional cash available for the LLC and then enter the amounts calculated below the column for cash available for other entity choices. (Note that cell referencing or a formula cannot be used as it results in a circular reference.) |

| Employer FICA taxes for: | |
|---|---|
| S corp & PSC - comp | S corp - distrib & PSC - div |
| 110,000 | 101,000 |
| Additional cash available: | |
| 590,000 | 599,000 |

**Federal Tax Table - Married Filing Joint**

| | | | | | |
|---|---|---|---|---|---|
| If taxable income is over: | 0 | 19,900 | 0.00 | 10.0% | Enter the 7 taxable income amounts 1st column of the married filing joint tax table |
| | 19,900 | 81,050 | 1,990.00 | 12.0% | |
| | 81,050 | 172,750 | 9,328.00 | 22.0% | |
| | 172,750 | 329,850 | 29,502.00 | 24.0% | |
| | 329,850 | 418,850 | 67,206.00 | 32.0% | |
| | 418,850 | 628,300 | 95,686.00 | 35.0% | |
| | 628,300 | no limit | 168,993.50 | 37.0% | |

| | | | | | |
|---|---|---|---|---|---|
| Tax rate on dividend income (assumed) | | | 15% | | |
| Capital Gains & Dividends | 0% | 15% | 20% | | |
| | taxable income | | single at | $445,851 | Enter where 20% starts (not currently used) |
| | | | married at | $501,601 | |

| | | |
|---|---|---|
| Entity level tax rate on PSC income | 21.0% | Enter highest tax rate for a corporation |

**Table 1**
**Choice of Business Entity Analysis**
**Data for Analysis**

**FICA taxes**

| | | | | | |
|---|---|---|---|---|---|
| SS ceiling amount | 142,800 | | | | Enter the social security (SS) ceiling amount |
| SS - employee rate | | 6.20% | | | |
| SS - employer rate | | 6.20% | | | |
| net earnings from SE | | | | 92.35% | |
| SS - self-employed rate | | | 12.40% | | |
| Medicare - employee rate | | 1.45% | | | |
| Medicare - employer rate | | 1.45% | 2.90% | | |
| Medicare – self-employed rate | | | 2.90% | | |
| Additional Medicare | 250,000 | | 0.90% | | Update amount for any changes. (At the moment, the amount stays the same every year.) |

**Table 2**
**Choice of Business Entity Analysis**
**As Employee**

| | | |
|---|---|---|
| Tax Year Used | 2021 | |
| Proposed percentage of ownership | 30% | 2% |
| Current compensation | 330,000 | 225,000 |
| Value of employer paid benefits (medical insurance) | 7,200 | 7,200 |
| Total gross compensation & value of benefits | 337,200 | 232,200 |
| Value of employer paid benefits (medical insurance) | (7,200) | (7,200) |
| Total gross compensation | 330,000 | 225,000 |
| Employee paid medical insurance | (7,200) | (7,200) |
| Amounts contributed to flexible spending accounts | (2,400) | (2,400) |
| FICA taxable compensation | 320,400 | 215,400 |
| Employee paid retirement savings | (19,500) | (19,500) |
| Federal taxable compensation | 300,900 | 195,900 |
| | | |
| SS taxes - employer | 8,854 | 8,854 |
| Medicare taxes - employer | 4,646 | 3,123 |
| FICA taxes - employer | 13,500 | 11,977 |
| | | |
| SS taxes - employee | 8,854 | 8,854 |
| Medicare taxes - employee | 4,646 | 3,123 |
| Additional Medicare | 634 | 0 |
| FICA taxes - employee | 14,134 | 11,977 |
| | | |
| Federal taxable compensation | 300,900 | 195,900 |
| For AGI deductions | | |
| Adjusted gross income (AGI) | 300,900 | 195,900 |
| Married-joint using standard deduction | (25,100) | (25,100) |
| Taxable income | 275,800 | 170,800 |
| | | |
| Federal taxes before credits | 54,234 | 29,073 |
| | | |
| Child tax credit before phase out | 4,000 | 4,000 |
| Phase out | 0 | 0 |
| Child tax credit after phase out | 4,000 | 4,000 |
| | | |
| Federal taxes after credits | 50,234 | 25,073 |
| | | |
| Federal taxable compensation | 300,900 | 195,900 |
| FICA taxes - employee | (14,134) | (11,977) |
| Federal taxes before credits | (50,234) | (25,073) |
| After-tax cash flow | 236,532 | 158,850 |

**Table 3**
**Choice of Business Entity Analysis**
**PSC - as owner - employee - extra cash as compensation**

| | | |
|---|---|---|
| Tax Year Used | 2021 | |
| Proposed percentage of ownership | 30% | 2% |
| | | |
| Current compensation | 330,000 | 225,000 |
| Allocation of additional cash (paid as bonus) | 177,000 | 11,800 |
| Value of employer paid benefits (medical insurance) | 7,200 | 7,200 |
| Total gross compensation & value of benefits | 514,200 | 244,000 |
| Value of employer paid benefits (medical insurance) | (7,200) | (7,200) |
| Total gross compensation | 507,000 | 236,800 |
| Employee paid medical insurance | (7,200) | (7,200) |
| Amounts contributed to flexible spending accounts | (2,400) | (2,400) |
| FICA taxable compensation | 497,400 | 227,200 |
| Employee paid retirement savings | (19,500) | (19,500) |
| Federal taxable compensation | 477,900 | 207,700 |
| | | |
| SS taxes - employer | 8,854 | 8,854 |
| Medicare taxes - employer | 7,212 | 3,294 |
| FICA taxes - employer | 16,066 | 12,148 |
| | | |
| SS taxes - employee | 8,854 | 8,854 |
| Medicare taxes - employee | 7,212 | 3,294 |
| Additional Medicare | 2,227 | 0 |
| FICA taxes - employee | 18,293 | 12,148 |
| | | |
| Federal taxable compensation | 477,900 | 207,700 |
| Income (not compensation) | 0 | 0 |
| For AGI deductions | 0 | 0 |
| AGI | 477,900 | 207,700 |
| Married-joint using standard deduction | (25,100) | (25,100) |
| Taxable Income | 452,800 | 182,600 |
| | | |
| Federal income tax (as owner - employee) | 107,569 | 31,866 |
| | | |
| Child tax credit before phase out | 4,000 | 4,000 |
| Phase out | 3,900 | 0 |
| Child tax credit after phase out | 100 | 4,000 |
| | | |
| Federal taxes after credits | 107,469 | 27,866 |
| | | |
| Federal taxable compensation | 477,900 | 207,700 |
| FICA taxes - employee | (18,293) | (12,148) |
| Federal income tax (as owner - employee) | (107,469) | (27,866) |
| After-tax cash flow (as owner-employee) | 352,138 | 167,686 |
| | | |
| Difference in cash flow (owner vs employee) | 115,606 | 8,836 |

**Table 4**
**Choice of Business Entity Analysis**
**PSC - as owner - employee - extra cash as dividends**

| | | |
|---|---|---|
| Tax Year Used | 2021 | |
| Proposed percentage of ownership | 30% | 2% |
| | | |
| Allocation of additional cash | 179,700 | 11,980 |
| Entity level tax | (37,737) | (2,516) |
| Dividends after entity level tax | 141,963 | 9,464 |
| | | |
| Current compensation | 330,000 | 225,000 |
| Value of employer paid benefits (medical insurance) | 7,200 | 7,200 |
| Total gross compensation & value of benefits | 337,200 | 232,200 |
| Value of employer paid benefits (medical insurance) | (7,200) | (7,200) |
| Total gross compensation | 330,000 | 225,000 |
| Employee paid medical insurance | (7,200) | (7,200) |
| Amounts contributed to flexible spending accounts | (2,400) | (2,400) |
| FICA taxable compensation | 320,400 | 215,400 |
| Employee paid retirement savings | (19,500) | (19,500) |
| Federal taxable compensation | 300,900 | 195,900 |
| | | |
| SS taxes - employer | 8,854 | 8,854 |
| Medicare taxes - employer | 4,646 | 3,123 |
| FICA taxes - employer | 13,500 | 11,977 |
| | | |
| SS taxes - employee | 8,854 | 8,854 |
| Medicare taxes - employee | 4,646 | 3,123 |
| Additional Medicare | 634 | 0 |
| FICA taxes - employee | 14,134 | 11,977 |
| | | |
| Federal taxable compensation | 300,900 | 195,900 |
| Dividends | 141,963 | 9,464 |
| AGI | 442,863 | 205,364 |
| Married-joint using standard deduction | (25,100) | (25,100) |
| Taxable income | 417,763 | 180,264 |
| | | |
| Taxable income taxed at preferential rates (dividends) | 141,963 | 9,464 |
| Federal tax on income taxed at preferential rates | 21,294 | 1,420 |
| | | |
| Taxable income taxed at ordinary rates | 275,800 | 170,800 |
| Federal tax on income taxed at ordinary rates | 54,234 | 29,073 |
| | | |
| Federal taxes (as owner - employee) | 75,528 | 30,493 |
| | | |
| Child tax credit before phase out | 4,000 | 4,000 |
| Phase out | 2,150 | 0 |
| Child tax credit after phase out | 1,850 | 4,000 |
| | | |
| Federal taxes after credits | 73,678 | 26,493 |
| | | |
| Federal taxable compensation | 300,900 | 195,900 |
| Dividends | 141,963 | 9,464 |
| FICA taxes - employee | (14,134) | (11,977) |
| Federal taxes (as owner - employee) | (73,678) | (26,493) |

**Table 4**
**Choice of Business Entity Analysis**
**PSC - as owner - employee - extra cash as dividends**

| | | |
|---|---|---|
| After tax cash flow (as owner-employee) | 355,051 | 166,894 |
| Difference in cash flow (owner vs employee) | 118,519 | 8,044 |

**Table 5**
**Choice of Business Entity Analysis**
**As S corporation shareholder-employee - extra cash as compensation**

| | | |
|---|---|---|
| Tax Year Used | 2021 | |
| Proposed percentage of ownership | 30% | 2% |
| | | |
| Current compensation | 330,000 | 225,000 |
| Extra cash (treated as compensation) | 177,000 | 11,800 |
| Value of employer paid benefits (medical insurance) | 7,200 | 7,200 |
| Total gross compensation & value of benefits | 514,200 | 244,000 |
| Value of employer paid benefits (medical insurance) | | (7,200) |
| Total gross compensation | 514,200 | 236,800 |
| Employee paid medical insurance | | (7,200) |
| Amounts contributed to flexible spending accounts | | (2,400) |
| FICA taxable compensation | 514,200 | 227,200 |
| Employee paid retirement savings | (19,500) | (19,500) |
| Federal taxable compensation | 494,700 | 207,700 |
| | | |
| SS taxes - employer | 8,854 | 8,854 |
| Medicare taxes - employer | 7,456 | 3,294 |
| FICA taxes - employer | 16,310 | 12,148 |
| | | |
| SS taxes - employee | 8,854 | 8,854 |
| Medicare taxes - employee | 7,456 | 3,294 |
| Additional Medicare | 2,378 | 0 |
| FICA taxes - employee | 18,688 | 12,148 |
| | | |
| Federal taxable compensation | 494,700 | 207,700 |
| Allocable income (not compensation) | 0 | 0 |
| Self-employed health insurance deduction (100%) | (14,400) | 0 |
| AGI | 480,300 | 207,700 |
| Married-joint using standard deduction | (25,100) | (25,100) |
| QBI deduction | 0 | 0 |
| Taxable income | 455,200 | 182,600 |
| | | |
| Federal taxes (as shareholder-employee) | 108,409 | 31,866 |
| | | |
| Child tax credit before phase out | 4,000 | 4,000 |
| Phase out | 4,000 | 0 |
| Child tax credit after phase out | 0 | 4,000 |
| | | |
| Federal taxes after credits | 108,409 | 27,866 |
| | | |
| Federal taxable compensation | 494,700 | 207,700 |
| Amounts paid for medical insurance | (14,400) | |
| Amounts paid for medical costs (equivalent to flexible spending) | (2,400) | |
| FICA taxes - employee | (18,688) | (12,148) |
| Federal taxes (as shareholder-employee) | (108,409) | (27,866) |
| After-tax cash flow (as shareholder-employee) | 350,803 | 167,686 |
| | | |
| Difference in cash flow (shareholder vs employee) | 114,271 | 8,836 |
| | | |
| Taxable income before QBI deduction | 455,200 | 182,600 |
| | NO | YES |

**Table 5**
**Choice of Business Entity Analysis**
**As S corporation shareholder-employee - extra cash as compensation**

| | |
|---|---|
| Qualified business income (QBI) | 0 |
| QBI deduction | 0 |

**Table 6**
**Choice of Business Entity Analysis**
**As S corporation shareholder-employee - extra cash as distribution**

| | | |
|---|---|---|
| Tax Year Used | 2021 | |
| Proposed percentage of ownership | 30% | 2% |
| | | |
| Additional allocable income (assume extra cash distributed = allocable income) | 179,700 | 11,980 |
| | | |
| Current compensation | 330,000 | 225,000 |
| Value of employer paid benefits (medical insurance) | 7,200 | 7,200 |
| Total gross compensation & value of benefits | 337,200 | 232,200 |
| Value of employer paid benefits (medical insurance) | | (7,200) |
| Total gross compensation | 337,200 | 225,000 |
| Employee paid medical insurance | | (7,200) |
| Amounts contributed to flexible spending accounts | | (2,400) |
| FICA taxable compensation | 337,200 | 215,400 |
| Employee paid retirement savings | (19,500) | (19,500) |
| Federal taxable compensation | 317,700 | 195,900 |
| | | |
| SS taxes - employer | 8,854 | 8,854 |
| Medicare taxes - employer | 4,889 | 3,123 |
| FICA taxes - employer | 13,743 | 11,977 |
| | | |
| SS taxes - employee | 8,854 | 8,854 |
| Medicare taxes - employee | 4,889 | 3,123 |
| Additional Medicare | 785 | 0 |
| FICA taxes - employee | 14,528 | 11,977 |
| | | |
| Federal taxable compensation | 317,700 | 195,900 |
| Allocable income (not compensation) | 179,700 | 11,980 |
| Self-employed health insurance deduction (100%) | (14,400) | |
| AGI | 483,000 | 207,880 |
| Married-joint using standard deduction | (25,100) | (25,100) |
| QBI deduction | 0 | (2,396) |
| Taxable income | 457,900 | 180,384 |
| | | |
| Federal taxes (as shareholder-employee) | 109,354 | 31,334 |
| | | |
| Child tax credit before phase out | 4,000 | 4,000 |
| Phase out | 4,000 | 0 |
| Child tax credit after phase out | 0 | 4,000 |
| | | |
| Federal taxes after credits | 109,354 | 27,334 |

**Table 6**
**Choice of Business Entity Analysis**
**As S corporation shareholder-employee - extra cash as distribution**

| | | |
|---|---|---|
| Federal taxable compensation | 317,700 | 195,900 |
| Allocable income (not compensation) | 179,700 | 11,980 |
| Amounts paid for medical insurance | (14,400) | |
| Amounts paid for medical costs (equivalent to flexible spending) | (2,400) | |
| FICA taxes - employee | (14,528) | (11,977) |
| Federal taxes (as shareholder-employee) | (109,354) | (27,334) |
| After-tax cash flow (as shareholder-employee) | 356,718 | 168,569 |
| | | |
| Difference in cash flow (shareholder vs employee) | 120,186 | 9,719 |
| | | |
| Taxable income before QBI deduction | 457,900 | 182,780 |
| | NO | YES |
| Qualified business income (QBI) | | 11,980 |
| QBI deduction | | 2,396 |

**Table 7**
**Choice of Business Entity Analysis**
**As LLC (taxed as a partnership) member**

| | | | |
|---|---|---|---|
| Tax Year Used | 2021 | | QBI |
| Proposed percentage of ownership | 30% | 2% | 2% |
| | | | |
| Assume that allocate income = extra cash to be distributed | | | |
| | | | |
| Current compensation (guaranteed payment) | 330,000 | 225,000 | |
| Health insurance paid by entity (guaranteed payment) | 7,200 | 7,200 | |
| Additional allocable income (pro rata) | 210,000 | 14,000 | 14,000 |
| Self-employment earnings | 547,200 | 246,200 | 14,000 |
| | | | |
| Net earnings from self-employment | 505,339 | 227,366 | 12,929 |
| | | | |
| SS taxes - employer-equivalent portion | 8,854 | 8,854 | 802 |
| SS taxes - employee-equivalent portion | 8,854 | 8,854 | 802 |
| Self-employed SS taxes | 17,708 | 17,708 | 1,603 |
| | | | |
| Medicare taxes - employer-equivalent portion | 7,327 | 3,297 | 187 |
| Medicare taxes - employee-equivalent portion | 7,327 | 3,297 | 187 |
| Self-employed Medicare taxes | 14,654 | 6,594 | 374 |
| | | | |
| Total self-employment taxes | 32,362 | 24,302 | 1,977 |
| | | | |
| Additional Medicare | 2,298 | 0 | |
| Total FICA taxes - self-employed | 34,660 | 24,302 | 1,977 |
| | | | |
| Deduction for employer-equivalent portion of self-employment tax | 16,181 | 12,151 | 989 |
| | | | |
| Self-employment earnings | 547,200 | 246,200 | |
| Deduction for employer-equivalent portion of self-employment tax | (16,181) | (12,151) | |
| Self-employed health insurance deduction (100%) | (14,400) | (14,400) | |
| Retirement contribution | (19,500) | (19,500) | |
| AGI | 497,119 | 200,149 | |
| Married-joint using standard deduction | (25,100) | (25,100) | |
| QBI deduction | 0 | (2,602) | |
| Taxable income (if LLC member) | 472,019 | 172,447 | |
| | | | |
| Federal taxes (if LLC member) | 114,295 | 29,435 | |
| | | | |
| Child tax credit before phase out | 4,000 | 4,000 | |
| Phase out | 4,000 | 0 | |
| Child tax credit after phase out | 0 | 4,000 | |
| | | | |
| Federal taxes after credits | 114,295 | 25,435 | |

**Table 7**
**Choice of Business Entity Analysis**
**As LLC (taxed as a partnership) member**

| | | |
|---|---|---|
| Self-employment earnings | 547,200 | 246,200 |
| Total FICA taxes - self-employed | (34,660) | (24,302) |
| Medical insurance payments | (14,400) | (14,400) |
| Retirement contribution | (19,500) | (19,500) |
| Federal taxes (if LLC member) | (114,295) | (25,435) |
| Medical payments equivalent to flexible spending | (2,400) | (2,400) |
| After-tax cash flow | 361,945 | 160,163 |
| | | |
| Difference in cash flow (member vs employee) | 125,413 | 1,313 |
| | | |
| Taxable income before QBI deduction | 472,019 | 175,049 |
| Eligible? | NO | YES |
| Qualified business income (QBI) | | 13,011 |
| QBI deduction | | 2,602 |

**Table 8**
**Choice of Business Entity Analysis**
**After-Tax Cash Flow Summarized**

| | 30% individual | change | rank | 2% individual | change | rank |
|---|---|---|---|---|---|---|
| Employee | 236,532 | | | 158,850 | | |
| LLC - with entity paying 1/2 of medical insurance | 361,945 | 125,413 | 1 | 160,163 | 1,313 | 4 |
| S corporation (extra cash as distribution) | 356,718 | 120,186 | 2 | 168,569 | 9,719 | 1 |
| S corporation (extra cash as compensation) | 350,803 | 114,271 | 5 | 167,686 | 8,836 | 2 |
| PSC (extra cash as dividends) | 355,051 | 118,519 | 3 | 166,894 | 8,044 | 3 |
| PSC (extra cash as compensation) | 352,138 | 115,606 | 4 | 167,686 | 8,836 | 2 |