00:00:04 Okay, let's talk taxes for a minute. Shall we? And I really do mean just a minute because we have a whole teaching on taxes in the tax section of LIFT. But for right now, I want to talk taxes as it has to do with choosing whether and how to incorporate your business. Here's the short story. If you do not incorporate,

00:00:26 or if you incorporate as an LLC and do not elect to be taxed as an S corporation, you will be taxed as a sole proprietor. If you are taxed as a sole proprietor, that means all of your business income and expenses are reported on your personal tax return here in the US. And that means you are more likely to be audited, and you are going to pay self employment taxes,

00:00:53 plus income taxes on all of your net income. Self employment taxes are approximately 15%. These are your payroll taxes, your FICA, your Fuda, you know, all those kinds of things, that are taken out of your paycheck when you are a w-2 employee. When you are working for an employer, your employer pays half of those taxes. So you pay just about seven and a half percent.

00:01:22 But when you're working for yourself, you pay that 15% on all of your income that is subject to self employment tax. So you obviously want to reduce the income that you have subject to self employment tax and save that 15% because that's a big hit to your bottom line. The way to do that is to be taxed as an S corporation and here's why. When you are taxed as an S corporation,

00:01:50 your corporation or LLC taxed as a corporation can make you an employee of your own business. Now, in that case, you have to pay yourself a reasonable salary for the services that you perform in your business, but you get to determine that amount. So let's say that you earn $60,000 of net income in your business or $5,000 a month. And you pay yourself out of that a $2,500 per month salary for your role.

00:02:24 That means that you'll set yourself up on payroll using a payroll service like gusto.com, which makes it super easy. And then you'll have your taxes taken out of your paycheck, just like when you were an employee and you'll pay self employment taxes on just that money. But what about the other $2,500 a month that you did not take out a salary, but you still earned as net income.

00:02:52 Will you take that out as owner's draw or as a distribution, which is the same thing, and you do not pay self employment tax on that. You will pay income tax on that, at your income tax rate, but you will not pay the self employment tax on that, saving you 15%. So let's just look at the savings for a minute here. Let's imagine that Sally earns $150,000 of net income and is taxed as a sole proprietor,

00:03:21 meaning that in addition to the regular income tax, that Sally will pay on her $150,000, she's going to pay $22,500 in self employment tax. Ouch, that hurts. But now let's

imagine that Sally was incorporated as an S corporation and of that $150,000 of net income, just $50,000 of that was Sally's salary. In that case, her self employment tax was only $7,500,

00:03:54 meaning that incorporating and paying taxes as an S corporation saved Sally $15,000 in self employment taxes, and made it way more likely that Sally wouldn't be audited to boot. We call that a win-win. All right. I will see you in our next session.