

Planning Considerations for Corporation Structure **A Note on 2018 Federal Tax Reform**

To C or not to C-Corp

When a taxpayer first sees that 21 percent tax rate for the C corporation, it seems that this could be the choice of entity for your business operation. Further, when you find yourself in the out-of-favor group for the 20 percent deduction authorized by new tax code Section 199A, you may ponder the C corporation, as a means of alleviating some tax.

The table below takes a good look at how one would pay taxes on profits, depending on your Form 1040 tax bracket. In the S corporation column, we listed the tax rates by the brackets that apply to individuals. To see exactly how this table works, let's say that you are in the 34 percent tax bracket and have \$100,000 in profits.



S Corp.	C Corp.	C Corp. Rate on 1120	Dividends on 1040	79% of Dividends	79% of 3.8% NIIT
10%	21%	21%	0%		
12%	21%	21%	0%		
22%	32.85%	21%	15%	11.85%	
24%	35.85%	21%	15%	11.85%	3.002%
34%	35.85%	21%	15%	11.85%	3.002%
35%	35.85%	21%	15%	11.85%	3.002%
37%	39.80%	21%	20%	15.5%	3.002%

For an S-Corporation:

- ✓ The profits come to you on a K-1 and you pay your Form 1040 taxes at the 34 percent rate, for a total tax of \$34,000 on your S corporation profits.

? You might ask: Why no NIIT on the S corporation profits?

Answer: If the shareholder materially participates in the S corporation, the NIIT does not apply to the pass-through income derived from active business operations. In the table below, we treat you as materially participating in your S corporation.

For a C-Corporation:

- ✓ The profits are first taxed at the C corporation level at a rate of 21 percent, for a tax of \$21,000. This leaves you with \$79,000 of the \$100,000 in profits available for distribution as a dividend to you.
- ✓ You are in your "give me the money" mode, so to get the cash, you endure the double taxation, starting with the dividend tax of 15 percent. This creates an \$11,850 tax (\$79,000 x 15 percent).
- ✓ Your tax bracket also triggers the net investment income tax (NIIT) that applies because of your dividend income. The NIIT is \$3,002 (\$79,000 x 3.8 percent).

As a C corporation, your total federal taxes on the \$100,000 of income are \$35,852, which consists of the following: C corporation taxes of \$21,000, 1040 dividend taxes of \$11,850 and 1040 NIIT of \$3,000.



S Corp = \$34,000 versus C Corp = \$35,852

Based on the same \$100,000 in profits, operating as an S corporation results in \$34,000 to the government compared with the C corporation, where you and the corporation combined pay \$35,853.

So the winner is: the S corporation. In all cases, the S corporation pays less in taxes. So, based on the tax rates alone, you have no reason to switch to the C corporation because of the recent tax reform. Please reach out to your Baratz accountant if you have questions. Also, see our Note on Specified Services Businesses and additional information posted at baratzcpa.com on the 2018 tax reform.