The Foresight Companies, LLC
Accounting News

THE FORESIGHT COMPANIES, LLC

What Foresight Accounting Has Been Working On, Doing and Learning This Month AUGUST 2014

Salary or Draw? How to Pay Yourself as a Business Owner

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Congratulations! Your small business has finally become profitable and now you can afford to pay yourself. You may have worked for free in the early days and now it's time to pay yourself for your efforts.

Based on the structure of your business, you generally have two options for taking home a paycheck:
1. A salary
2. And/or a draw.

C Corporations - If you are an officer of a corporation, the law states you must be on the payroll and receive regular checks that include withholding for Social Security, Medicare, Federal Income Taxes, and if required, State Income Taxes.

S Corporations - If your company is legally structured as an S Corporation, you must receive regular paychecks, with withholdings, but you have the option of taking additional money beyond your salary in the form of a draw or distribution. Checks for draws and distributions do not have taxes withheld.

Before you start cutting checks to yourself, you need to carefully consider the total amount of your salary and draws. Owners of S Corporations have come under increased scrutiny the past several years, as they typically prefer to take draws rather than payroll to avoid paying the associated employer payroll taxes. It's imperative for business owners to understand the position the IRS takes on reasonable compensation. One of the largest financial risks to enterpreneurs is penalties and interest for incorrect payroll-tax reporting.

Sole Proprietors and Partners - Sole proprietors and members of partnerships may choose pay themselves a salary with payroll withholding, or take profits out of their businesses as a draw. Payroll withholdings are not required by law, but you will report and pay the taxes due on the draws when filing your personal tax return.

So, how do you decide how much to take as a salary and how much to take as a draw? As for your salary, the IRS requires you to earn "reasonable compensation" for the type of work that you're doing. As a guideline, the government suggests choosing an amount similar to what another business would pay someone to do what you do.

When paying yourself a draw, you must consider the eventual tax bill. You can implement a system as simple as keeping the cash in an envelope in your sock drawer to pay the taxes, or paying quarterly estimated tax payments to the IRS. You have to make quarterly estimates if both of the following are true:

1. You expect to owe at least $1000 to the IRS this year (above what you have had withheld from salary)
2. You expect your current year's withholdings and credits to be the lesser of
    a. 90% of current year's taxes or
    b. 100% of last year's taxes.

For our accounting clients, we will be contacting you in the next few months to review your year-to-date financials, salary and withholdings to determine if you need to start, increase or decrease your estimated payments.