The Solo's Guide to S Corps: What You Need to Know to Keep More of What You Earn

About Lettuce

Before we get into the good stuff, let's answer this question: Who are we, and why are we qualified to give you advice?

We're Lettuce, an automated tax and accounting system built by and for solopreneurs. We automate your taxes, handle all of your accounting, and manage your S Corp setup from start to finish. From paperwork and filings to taxes and ongoing compliance, Lettuce deals with all of it for you so you can unlock thousands in savings—without all the hassles.

You know what nobody (*okay, almost nobody*) has ever said? “I started my solo business because I was so excited about doing paperwork and taxes.”

Things like taxes, business entities, and balance sheets inspire all of the groans and eye rolls among the self-employed crowd—and they certainly aren’t the stuff of your solopreneurial dreams.

But while they’re not exciting, they’re essential. Knowing what’s what helps you make smarter decisions and run a more successful and sustainable business.

Case in point? S Corps. Maybe you’ve heard some buzz about S Corps in your solopreneur journey so far (or maybe not). Either way, you can’t decide whether or not an S Corp is the right fit for you without first understanding the basics of all of the less-than-glamorous—yet undeniably important—aspects of running your solo business.

So, grab a snack and get ready to walk away with an understanding of all of the different business structures, a general grasp on how taxes work when you’re self-employed, and insights into why and how an S Corp just might be the tax-saving secret you’ve been looking for.

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Let's Talk S Corps and Business Entities

(Without Putting You to Sleep)

We're guessing that you came to this guide because you want to learn more about S Corps—and, rest assured, you'll find plenty of helpful information in these pages.

But you'll build a much better understanding of S Corps (and be able to determine if this tax status is the right fit for you) if you get the lowdown on all of the other business entities available to you. So, let's start by getting the lay of the land.

A business entity is a legal structure that determines how your business is organized, taxed, and held liable. When you're self-employed, there are a variety of different business entities you can choose from. However, these are the most common for solopreneurs:

Sole proprietor

Not to be confused with solopreneur, sole proprietorship is a business structure in which the business and the owner are the same entity.

This means the owner is personally liable for all business debts and legal claims, and taxes are paid on personal returns. The perk of this option is that there's no setup involved. So, if you haven't done any legwork to establish a business entity, then you're currently a sole proprietor.

LLC

A Limited Liability Company (LLC) gives you far more liability protection because it separates your business finances and obligations from your personal ones.

Your personal assets (think things like your personal savings account or your home) aren't at risk if your business goes into debt or gets into legal hot water.

S Corp

While it's commonly grouped with business entities, an S Corp isn't actually an entity on its own—it's a tax classification. Put simply, it changes the way your business is taxed by allowing you to be both the owner of your company and its sole employee.

We'll get into the nitty gritty of what this means a little later. For now, just understand that it's something you can elect on top of an established business entity. So, for example, your business might be an LLC that's taxed as an S Corp.

There are other business entities too, like partnerships, C Corps, or nonprofits. But, in the case of solopreneurship, the above three are the most likely routes.

Establishing a formal entity for your business might sound complex and intimidating. However, it doesn't need to be nearly as complicated as you might think—and it offers plenty of compelling benefits like better protection for your assets and potentially even major tax savings.

What's In a Name?

Deciding What to Call Your Business

If and when you decide to establish a formal business entity (like an LLC), you need to choose a business name. It's a big decision, and there are a couple of important things to keep in mind as you brainstorm monikers for your business baby:

- [ ] **Uniqueness:**

  Your state requires that your chosen business name hasn't been registered before. Beyond checking your state's business registry, it's smart to also check domain availability and social handles to ensure you don't run into any branding roadblocks.

- [ ] **Clarity:**

  Ideally, your name will clearly communicate what your business does. Avoid overly clever or vague names that could confuse your potential clients.

- [ ] **Scalability:**

  If you plan to grow your business in the future, choose a name that can grow alongside you. For example, using only your name might not fit if you decide to build a team down the line.

Still struggling to come up with the right fit?

Ask yourself these questions for a little more creative inspiration when naming your business:

- [ ] What do I want people to instantly understand or feel when they hear my business name?
- [ ] Are there words, phrases, or metaphors I keep returning to when I talk about my work?
- [ ] What sets my business apart from others offering similar services or products?
- [ ] If my brand were a person, how would I describe their personality in three words?
- [ ] What words or names do my ideal customers already associate with trust, expertise, or creativity?

Give this step the time and consideration it deserves, but try not to stress too much. If you end up being unhappy with the name you register, you can file a form with your state to create a DBA (Doing Business As) name. This allows you to operate under a different name while keeping your LLC's legal name.

Is an LLC Right for You?

How to Make Your Decision and Move Forward

You don't have to have an LLC to run a successful business. If you're running a lean solo business, aren't in a hurry to expand overhead by hiring employees, and want to keep your costs low, then staying as a sole proprietor is likely your best option.

But, if you're planning to grow or legitimize your business, then an LLC makes the most sense for protecting your assets and getting some different tax benefits. One downside of LLCs? There's a little more paperwork involved than the sole proprietorship route.

On this paperwork, you'll be asked for a couple of things that might leave you scratching your head. Here's a quick rundown so you can finish that paperwork with more confidence (and less confusion):

> **Registered agent:**
> A registered agent is responsible for receiving legal and tax documents on behalf of your business. In the vast majority of cases, you will be the registered agent for your LLC.
>
> **Articles of organization:**
> These are official documents you file with the state that outline essential details, including your business name, address, the purpose of your business, and the date you'll start.

Here are a few more questions (and quick answers) you'll likely have about your LLC:

Can a sole proprietor be an LLC?

By definition, a sole proprietor can not be an LLC—but a sole proprietor can easily decide to form one.

Can I live in a different state from my LLC?

Yes, you can live in a different state than your LLC. However, you will need to register your LLC as a foreign entity in the state where you reside and conduct business.

How much is it to start an LLC?

It depends on the state where you operate your business, as filing fees and taxes will vary. However, the overall costs can add up to a few thousand dollars. Fortunately, you can write off a good chunk of these as startup fees.

Already feel your eyes glazing over?

Let Lettuce do the dirty work for you. Sign up and Lettuce will take care of establishing your business entity without all of the problems and paperwork.

Understanding the Tax Side of Going Solo

The business entities we mentioned all have their unique pros and cons. But before you can really understand what sets those entities apart (and what makes an S Corp so powerful), you first need to understand your tax obligations as a solo business owner.

In a traditional W2 job, your taxes are automatically withheld from your paycheck. Beyond filling out a tax form when you start, there's nothing you need to actively do to pay your taxes.

That's not the case when you're self-employed. You're responsible for paying your income tax and something called **self-employment** tax on your own.

Wait... What's Self-Employment Tax?

It might sound like these are taxes only for self-employed people. However, traditional employees still pay these taxes—just in a different way.

"Self-employment tax" is the term for Social Security and Medicare taxes. When you're an employee, your employer splits these taxes with you. But, as a solopreneur, you're both the employer and the employee, which means you're on the hook for the total amount.

Currently, the self-employment tax rate sits at **15.3% of your net earnings**.

This breaks down to 12.4% for Social Security and 2.9% for Medicare. It might sound like an eye-popping number, but don't panic yet—we'll cover strategies to keep this number as low as possible a little later.

You'll pay your income tax and your self-employment tax four times each year with your quarterly estimated tax payments.

Quarterly... Huh? What to Know About Estimated Tax Payments

The most important thing to know is that, since these payments cover your income and self-employment taxes, they're required. Skipping them can mean penalties and large tax bills.

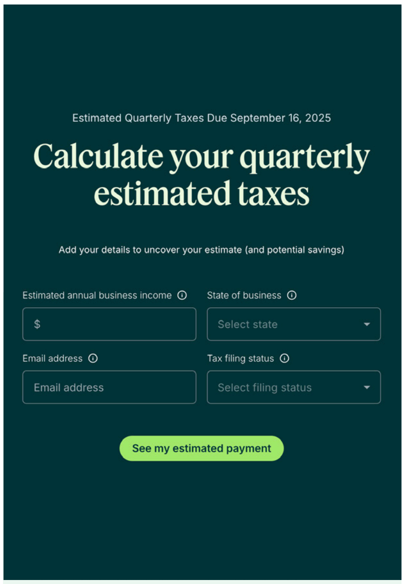
You'll need to pay these taxes to the IRS four times each year by the following due dates:

April 15	June 15	Sept 15	Jan 15

If one of those dates falls on a weekend or a holiday, then the due date is pushed to the business day immediately following.

How Much Do You Pay Each Quarter?

The answer differs for everyone, as it hinges on your expected income, deductions, and credits for the year. Here's how you can figure out how much you should send in (or you can use Lettuce's easy quarterly tax calculator):



When you're ready to send in your money each quarter, you can do so by using:

the IRS Direct Pay system

or

the Electronic Federal Tax Payment System

or

by sending a check with a Form 1040-ES voucher to the appropriate IRS address.

Step #1: Estimate Your Annual Income

Calculate your gross income:
Make your best, most educated guess about how much you'll earn for the year. Remember to include all sources of income, including interest, dividends, rental income, and more.

Adjust for deductions:
Subtract any deductions you anticipate, such as your typical business expenses and other itemized deductions like mortgage interest, charitable contributions, and medical expenses.

Step #2: Determine Your Taxable Income

Subtract your adjustments:
Now subtract any other adjustments to your income, such as contributions to a traditional IRA, student loan interest, and health savings account (HSA) contributions.

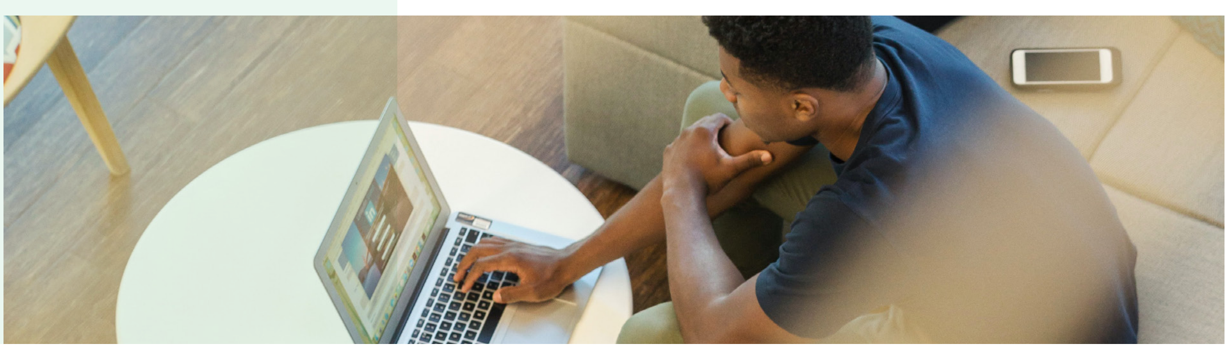
Step #3: Calculate Your Annual Tax Liability

Find your tax rates:
Apply the appropriate federal tax rates to your taxable income. You can find the current tax rates on the IRS website.

Apply credits:
Subtract any tax credits you expect to qualify for, such as the Child Tax Credit or the Earned Income Tax Credit.

Step #4: Do the Math

Divide by four:
Divide your total estimated tax liability by four to determine the amount you should pay each quarter.



Tackling Your Taxes With the Money-Saving Magic of S Corps

Here's the truth: Even when you understand the importance of taxes, handing over your hard-earned money every quarter can be painful. Understandably, most solopreneurs are eager to find ways to lower their tax bill—while still being compliant, of course.

We briefly covered business entities above, but it's worth digging into this more as it's the most meaningful lever you can pull to save major money on your taxes.

How? It all comes back to your self-employment taxes.

As a sole proprietor or LLC, you pay self-employment tax on your total taxable income. So, if your taxable income is $162,000 you're paying 15.3% taxes on that entire amount.

But, as an S Corp, you split your business income into two different buckets:

> **Salary:**
> You get to decide what you "pay" yourself, as long as it's reasonable and aligned with what someone else in your role would earn.
>
> **Distributions:**
> The rest of your income is taken as distributions. You still have access to this money, but it doesn't count as your personal income.

Why is this helpful?

As an S Corp, you only pay self-employment taxes on your salary.

The rest of your income (in the form of distributions) isn't subject to self-employment taxes.

Your taxes today

Self-Employed

Your Revenue
$175k

Your Taxable Income
$162k
92.35% of revenue

Self-Employment Tax
15.3%

You Pay
$24,768
Self-Employment Tax, for Social Security + Medicare

Your taxes with Lettuce

LLC + S-Corp + Lettuce Optimizer

You Save
$14,058

Your Revenue
$175k

Owner's Distribution
$105k

Salary
$70k

SS + Medicare Tax
0%

SS + Medicare Tax
15.3%

You Pay
$0
Social Security + Medicare Taxes on Owner's Distribution

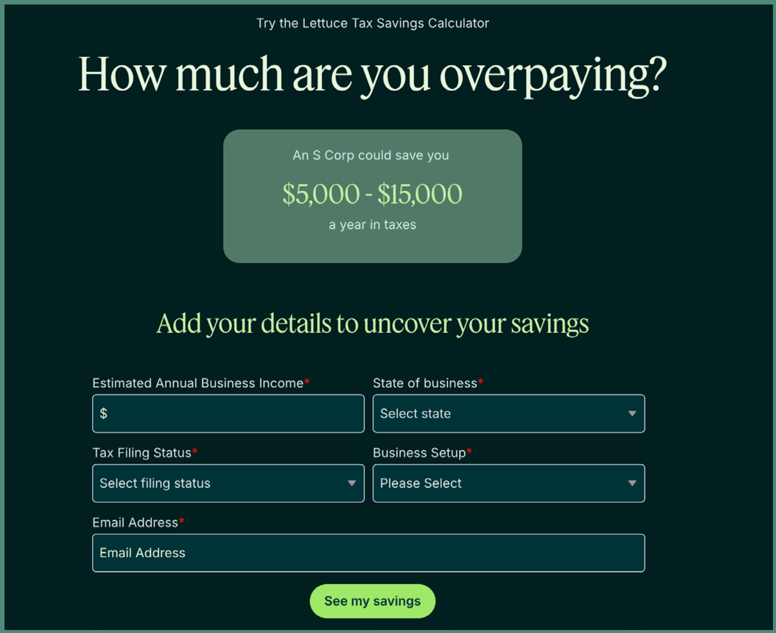
You Pay
$10,710
Social Security + Medicare Taxes on Salary

Let that sink in.

As an LLC or sole proprietor, you're paying the 15.3% tax rate on all of your $162,000. But, if you elected to be taxed as an S Corp and set your salary at $70,000, then you'd only pay self-employment tax on $70,000. That's where the major tax savings come into play.

While an S Corp can help you keep more of your money in your bank account, there are a few drawbacks to be aware of. With more complex tax filings and stringent compliance rules, an S Corp does require a little more diligence than you need when you're a sole proprietor.

How much could you save by making the switch to an S Corp? Plug your numbers into Lettuce's tax calculator and find out.



When Is the "Right" Time to Become an S Corp?

Not sure if an S Corp is the best fit for you? There isn't necessarily a "right" answer here. However, if you check off all of the following, take it as a solid sign that an S Corp could be your ticket for significant tax savings:

- ✓ You're earning above $60,000 in profit
- ✓ You're frustrated by how much you're paying in self-employment taxes
- ✓ You're dedicated to your solo business—it's not just something you're dabbling in
- ✓ You're committed to thorough bookkeeping
- ✓ You intend to run your business for the foreseeable future

Is Lettuce right for you?

See if Lettuce can help you keep more of what you earn with our short quiz.

Take the Quiz

How to Become an S Corp:

5 Steps to Make It Happen

Ready to take the leap and become an S Corp? There are a few important steps you'll need to take to get your election done and stop overpaying your self-employment taxes.

Don't Want to Go the DIY Route? We Don't Blame You

Can you DIY your S Corp? Sure. Do you *have* to? Definitely not. In fact, unless you consider yourself a tax and accounting whiz, we recommend using your resources (and your time) wisely and looking for ways that AI and automation can help you streamline the process.

That's where Lettuce comes in. We'll help you skip all of the grunt work by completing and managing your S Corp election *for* you. We'll handle:

- ✓ Establishing your LLC (if you don't already have one)
- ✓ Completing and filing your S Corp election (yep, even the paperwork)
- ✓ Calculating your reasonable salary
- ✓ Setting up your business bank account and a debit card
- ✓ Automatically setting aside and paying your taxes each pay cycle, so you're covered year-round
- ✓ Setting up payroll and managing all the complex state tax registrations and filings
- ✓ All of your ongoing accounting and compliance tasks, including S Corp payroll

With Lettuce, you'll get all of the benefits of an S Corp—without any of the burdens.

Whether you ultimately choose to handle it all yourself or you want to understand the process before deciding if Lettuce is right for you, it's helpful to know what's required to complete your S Corp election. Here are the steps you'll take if you decide to go the DIY route:

1. Register as an LLC

Remember, an S Corp isn't a business entity on its own—it's a tax classification you can elect on top of your business entity. That means you need to start by establishing an LLC. To do so, you'll need to:

Know state-specific rules:
Understand the specific requirements for forming an LLC in your state.

File your documents:
Submit the necessary documents, such as your articles of organization, to the Secretary of State.

Create an operating agreement:
Draft an agreement outlining the rights and responsibilities of the members and the operational procedures of your business.

Obtain an EIN:
Get an Employer Identification Number (EIN) from the IRS for tax purposes.

Check local licensing requirements: Ensure you have all the necessary local licenses and permits.

2. File Form 2553

Form 2553 is the form you need to submit to the IRS to elect S Corp status. You're on a timeline here. You need to submit this form within two months and 15 days after the start of the tax year in which you want the election to take effect.

For a new LLC, you have a 75-day window to apply for S Corporation status from the date of formation. If you're an existing LLC, making the election by March 15th will make the S-corp status apply for the full year.

3. Open Your Business Bank Account

Setting up a dedicated business bank account is always a good idea when you're self-employed—but it's crucial when you're an S Corp or an LLC, as your business is its own legal entity.

With a separate bank account, you benefit from the full protections of your business entity, keep cleaner financial records, and can take advantage of all of your available deductions.

4. Determine Your Reasonable Salary

Your reasonable salary is the puzzle piece that leads to significant tax savings with an S Corp. However, you don't get to pick a number out of a hat just to maximize your tax savings. Reasonable is the operative word here.

Ask yourself: What would you pay someone else to perform this same job? That gives you a start, but the IRS considers several other factors to determine if a salary is reasonable:

What are others in your industry paid for similar work?

What level of experience and education do you have?

What are the skills required for the job?

What amount of time do you spend working for the company?

What is the overall profitability of your business?

Setting a salary that aligns with these factors—even if it means paying a little more in taxes—means you can run a more honest business while also avoiding the scrutiny of the dreaded IRS. Not sure how to set a reasonable salary? Lettuce will do it for you.

5. Track Your Numbers

Regardless of your business entity, you need to keep your business finances in check. That means tracking and categorizing all of your income and expenses, along with marking all of the important tax deadlines on your calendar.

Staying on top of your bookkeeping is how you'll maintain an accurate picture of your business's financial health while also setting yourself up for tax time that's as stress-free as possible.

From completing your S Corp election to running payroll to setting up your business bank account to automatically categorizing your transactions, Lettuce can take care of all of the above for you so you can focus on what matters most: your clients. Learn more now.

lettuce

Beyond Your Business Entity:

4 More Tax-Saving Strategies For Your Business of One

Especially if you're a higher earner, electing S Corp status will have the biggest impact on your tax bill—but it's not the only way to lower your tax burden. Here are four other tips to pay what you owe and not a penny more:

1 Business Expense Deductions

The purchases you make for your business (anything from software to office supplies to relevant training) can all be deducted from your income.

This lowers your taxable income and, as a result, your tax bill. If you're wondering whether or not an expense is deductible, ask yourself this: Does this help your business generate revenue?

If the answer is "yes," it's a legitimate deduction.

2 Retirement Plan Contributions

Contributing to a retirement plan like a SEP IRA or Solo 401(k) helps you save for the future while simultaneously reducing your taxable income.

Your contributions are tax-deductible up to certain limits.

3 Tax Credits

Unlike deductions, which reduce your taxable income, tax credits directly reduce the amount of tax you owe—dollar for dollar.

Look into credits like the home office credit, the health insurance credit for self-employed individuals, or energy-efficient equipment credits if they apply to your business.

4 Charitable Contributions

Donating to qualified charities through your business may be tax-deductible, depending on your business structure.

Even if you're a sole proprietor, you can often claim charitable contributions on your personal return. Just be sure to keep detailed records and confirm the organization is IRS-recognized.

You've Got This
(and We've Got You)

Let's be honest: Most people don't dream about tax structures and legal forms when they decide to strike out on their own. But, while they might not be glamorous, they're the behind-the-scenes essentials that keep your business legit and keep future surprises (and penalties) at bay.

By familiarizing yourself with the basics, you're saving yourself plenty of stress, time, and money down the line. And, remember, you don't have to be perfect—and you don't have to do it all alone.

Lettuce can help you with everything we covered in this guide. Yes, that means establishing your business entity, completing your S Corp election, setting up your business bank account, tracking and categorizing your transactions, and even making your quarterly tax payments for you.

Put it all on autopilot with Lettuce so you can spend less time on bookkeeping and more time on the work that drew you to self-employment in the first place.