



Payroll Processing for Different Business Entities

Presented by
Nellie Akalp, Founder & CEO

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CorpNet Founder and CEO

A pioneer in the online legal document filing space since 1997, Nellie has helped more than half a million small businesses and licensed professionals start and maintain companies across the United States, most recently through her Inc.5000 recognized company, CorpNet. She closely follows trends in the industry and shares her wealth of knowledge across various CPA and small business communities, establishing Nellie as one of the most prominent influential experts on business startup and compliance matters.



Today's Agenda

Once a business is established, entrepreneurs need to understand how to pay themselves and their employees. The selected business entity is the foundation for the payroll process and will help you understand the right payroll process for your clients.

In this webinar, we'll review:

- Payroll options for Sole Proprietorships and Partnerships
- If an LLC owner can be on payroll
- When an S Corporation is necessary
- Payroll options for Corporation members
- Steps for state payroll registration

Payroll Options for Sole Proprietorships and Partnerships



What is a Sole Proprietorship?

Entity Overview:

- A Sole Proprietorship is the simplest structure for operating a business owned by one person (or a married couple).
- By default, states will consider a single-owner business to be a Sole Proprietorship unless the owner (the sole proprietor) files business registration paperwork to form an LLC (Limited Liability Company) or a Corporation.
- Sole Proprietors are not considered employees of their companies.
- They get paid by withdrawing funds (taking owner's draws) out of their businesses for personal use.

Typical Usage:

Many freelancers, consultants, and other professional service providers work as Sole Proprietorships. The Sole Proprietorship structure is also attractive to entrepreneurs in other industries, too (retail, landscaping, cleaning, and more).

What is a Partnership?

Entity Overview:

- A Partnership is a legal entity where two (or more) people run a business.
- Like a Sole Proprietorship, each partner owns a portion of the assets and liabilities of the business.
- The main difference between a Sole Proprietorship and Partnership is that a Partnership relies on an agreement between the partners. This document, the partnership agreement, details ownership and responsibilities.
- Partners are jointly and severally liable. When the business gets sued, each partner can be drawn into the case. A judgment will apply to all concerned parties.

Typical Usage:

A Partnership is often best suited for a group of professionals in the same line of business where each partner has an active role in running the business. These types of businesses often include doctors, dentists, lawyers, accountants, and consultants.

Owner's Draw vs. Salary

Sole Proprietors and Partners are not employees and, thus, cannot earn a salary. Instead, they receive payment via an owner's draw from their business equity.

Owner's Draw:

- Sole Proprietorships and Partnerships generally pay themselves through an owner's draw.
- The IRS views owners of these entity types as self-employed, and as a result, they aren't paid through regular wages.
- Owner's draws are not taxed at the time they're taken out, and instead, taxes are applied to the owner's individual tax returns.

Salary:

- Salaries are set, recurring payments.
- Salaries are taxed by the state and federal governments at the time of disbursement.

Can a Sole Proprietor Have Employees?

- Sole Proprietors can and do have employees.
- Many start with family members and expand into traditional employees.
- Adding employees adds another layer of complexity to business management.
- Sole Proprietors will need to pay their employees, file and remit payroll taxes, and comply with employment regulations.
- Different tax requirements may apply, however, if the employee is a relative such as a spouse or a child.
 - If a spouse is an employee, FICA is required, but FUTA is not.
 - Children under the age of 18 are not subject to FICA taxes.
 - Children under the age of 21 are not subject to FUTA taxes.
 - All children, regardless of age, are subject to federal income tax.

Do you manage business incorporation and compliance activities for your organization or on behalf of your clients?

- Yes, for my organization
- Yes, on behalf of my clients
- Yes, I advise my clients
- Not currently, but I am interested in offering this service



**Polling
Question #1**

LLC Owners and Payroll



What is a Limited Liability Company ?

Entity Overview:

- Next to operating a business as a Sole Proprietor or Partnership, an LLC is the least complex and costly form of business to start and maintain from a state compliance perspective.
- Because an LLC is considered a separate legal entity from its members, its financial and legal responsibilities are also its own.
- By default, an LLC is considered a “disregarded entity” for tax purposes. Business income and losses are passed through to its members’ tax returns and are subject to members’ individual tax rates.

Typical Usage:

Business owners who are looking for personal liability protection, tax flexibility, and management options may find that forming an LLC will be an ideal choice for their company.

Can an Owner of an LLC Be on Payroll?

- Generally, no, an LLC owner cannot be on payroll.
- An LLC is considered a “disregarded entity” and taxed as either a Sole Proprietorship (one owner) or a Partnership (multiple owners).
- Owners are paid in owner’s draws or distributions from the business profits and may not be on the payroll.
- An LLC must complete payroll tax registration only if the business hires employees.
- If an LLC hires employees, it is subject to income taxes, FICA, FUTA, SUTA, and worker’s comp insurance.
- Employer-paid portion of payroll taxes may be deducted on LLCs’ income tax returns.

When an S Corporation is Necessary



What is an S Corporation?

Entity Overview:

- Although it is formed in the same manner as a C Corporation, the corporate entity makes an S Corporation election with the IRS to be taxed as a “pass-through entity” under subchapter S of the Internal Revenue Code.
- This means that an S Corporation is not a separately taxable entity; the profits and losses are passed-through and reported on the personal income tax returns of the shareholders, much like a Partnership.
- An S Corporation is a corporation that reports corporate income, losses, and deductions through its shareholders. Typically, the shareholder and/or owner reports corporate income on his/her personal income tax returns.

Typical Usage:

Business owners who are looking for personal liability protection similar to a corporate shareholder but prefer to be taxed as a Partnership or Sole Proprietorship, will opt for an S Corporation election.

When an S Corporation is Desirable

- If the LLC meets eligibility requirements and files for S Corporation election, then LLC members who work in the business must be put on the payroll and paid like employees.
- The company must register for tax accounts with the state and local government agencies.
- LLCs that opt for S Corporation tax treatment must not pay their members wages or salaries that are below what's reasonable for the work they perform.
- Some LLCs have faced penalties for paying themselves excessively low wages and taking the rest of their compensation as profit distributions in order to decrease their Social Security and Medicare tax burden.
- LLCs want to take this approach because wages and salaries are subject to those taxes in addition to income tax, while only income tax applies to profit distributions.

Defining Reasonable Compensation

- S Corporation owners who perform more than just minor work for the business typically need to be on the payroll because they must pay themselves a reasonable salary.
- Owners who take a salary that's below market value for the services they perform or claim all income through shareholder distributions may be audited and penalized by the IRS.
- A reasonable salary for S Corporation owners is one that a comparable business would pay an employee to perform similar job duties.
- To determine a reasonable salary, S Corporation owners can purchase compensation analysis reports or conduct their own research using the Bureau of Labor Statistics and other sites that provide salary information.
- The 60/40 rule is a simple approach that helps S Corporation owners determine a reasonable salary for themselves. Using this formula, they divide their business income into two parts, with 60% designated as salary and 40% paid as shareholder distributions.

Payroll Options for C Corporation Shareholders



What is a C Corporation?

Entity Overview:

- A C Corporation, also referred to as a general for-profit corporation, is a legal, taxable entity, separate from its owners.
- You'll often hear a C Corp's income tax treatment referred to as "double taxation." because first, the corporation pays taxes on its profits, and then the individual shareholders pay taxes on the dividend income they receive from the business.
- Even though forming a C Corp involves more legalities and formalities, the costs are reasonable compared to other business structures that do not offer the same level of liability protection, growth potential, and tax flexibility.

Typical Usage:

Business owners who plan on investing earnings back into the business often prefer the C Corporation structure as a way of deferring or reducing their federal income tax obligations.

Can a C Corporation's Shareholders be on Payroll?

- Yes, a C Corporation's shareholders (or members) may pay themselves via payroll for services rendered in running the business.
- Even if a Corporation has no other employees, it must register for payroll taxes if one or more of its shareholders are on the company's payroll.
- It's critical that shareholders on payroll pay themselves reasonable compensation for the work performed.
- Because wages and salaries are tax-deductible expenses for the business, the IRS requires that compensation paid to shareholders through payroll is not beyond a reasonable wage or salary for the work those individuals do for the business.
- This stipulation is meant to prevent business owners from gaming the system by paying themselves exorbitant salaries and low distributions (a.k.a. dividends, which are not tax-deductible) to lower their corporate taxable income.

How do you currently manage business incorporation and compliance activities?

- I currently use CorpNet
- I use another filing and compliance service
- Internet research and spreadsheets
- Other



**Polling
Question #2**

State Payroll Registration



Payroll Tax Overview

- In the United States, tracking, reporting, and paying payroll taxes are required legally to hire and pay employees.
- Some taxes must be withheld from employees' paychecks, and the employer must pay some.
- Businesses must register for the appropriate payroll tax accounts at the state and federal levels (and sometimes the local level if there is a local withholding tax) to process employee payroll and file returns.
- The rules and requirements vary by state, but generally, payroll taxes might include Federal Income Tax, State Income Tax, Local Income Tax , FUTA, SUI, Social Security Tax, and Medicare Tax.

Tax	Description	Government	Paid By
Income Tax Withholding	Taxes withheld from employee pay for federal income taxes owed by the employees. The amount is determined by the employee's W-4.	Federal & State	Employee
FICA Tax	Social security and Medicare taxes, called FICA (Federal Insurance Contributions Act), are shared between employees and employers.	Federal	Both
Additional Medicare Tax	An employer must withhold part of social security and Medicare taxes from employees' wages. The employer also pays a matching amount.	Federal	Employee
FUTA Tax	The Federal Unemployment Tax Act (FUTA) provides for payments of unemployment compensation to workers who have lost their jobs.	Federal	Employer
Self-Employment Tax	Self-employment tax (SE tax) is a social security and Medicare tax primarily for individuals who work for themselves.	Federal	Employee
Unemployment Insurance Tax	State unemployment instance (SUI) tax is similar to FUTA, but controlled at the state level. Amounts, requirements, and ownership vary by state.	State	Employer
Disability Tax or Insurance	Disability tax (or insurance) is controlled at the state level. Amounts, requirements, and ownership vary by state.	State	Employer
Worker's Compensation Tax	Provides temporary benefit payments to workers for non-work-related illness, injury, or pregnancy. Varies by state.	State	Employer
State and Local Income Tax	State income tax (SIT) and local taxes varied by state, county, or city.	State & Local	Employee

State Payroll Tax Accounts

State Income Tax (SIT):

- SIT is a required tax applied to an employee's wages.
- Small business owners are responsible for deducting SIT from an employee's gross wages and submitting this tax to the state's tax agency.
- All states require SIT withholdings except for Alaska, Florida, Nevada, New Hampshire, South Dakota, Tennessee, Texas, Washington, and Wyoming.

State Unemployment Insurance (SUI):

- If you hire employees, you are required to pay SUI on their wages.
- The SUI program offers short-term unemployment benefits to eligible workers who are unemployed because they have lost or left their jobs. SUI eligibility and benefits are determined by the individual state's laws.
- Employer taxes associated with SUI rates vary by state.

State	SIT	SUI	New Employer Rate
Alaska		Quarterly	1.86%
Alabama	Monthly, Quarterly	Quarterly	2.7%
Arkansas	Monthly	Quarterly	3.1%
Arizona	Quarterly, Annually, TTF	Quarterly	2%
California	Tied to Fed EFT	Quarterly	3.4
Colorado	Weekly, Monthly, Quarterly	Quarterly	1.7% - 6.82%
Connecticut	Weekly, Monthly, Quarterly	Quarterly	2.8%
District of Columbia	Monthly	Quarterly	2.9%
Delaware	Monthly, Quarterly	Quarterly	1.2%
Florida		Quarterly	2.7%
Georgia	Daily, Semi-Weekly, Monthly, Quarterly	Quarterly	2.7%
Hawaii	Semi-Weekly, Monthly, Quarterly	Quarterly	4%
Iowa	Semi-Weekly, Monthly, Quarterly	Quarterly	1% - 7.5%

State	SIT	SUI	New Employer Rate
Idaho	Monthly, Semi-Monthly, Quarterly, Annually	Quarterly	.8%
Illinois	Monthly, Semi-Monthly, Annually	Quarterly	3.95%
Indiana	Monthly	Quarterly	1.6% - 2.5%
Kansas	Monthly, Semi-Monthly, Quarterly, Quad Monthly, Annually	Quarterly	2.7% - 6%
Kentucky	Monthly, Semi-Monthly, Quarterly	Quarterly	2.7% - 9%
Louisiana	Monthly, Semi-Monthly, Quarterly	Quarterly	.15% - 2.86%
Massachusetts	Monthly, Monthly, Quarterly, Quarter Monthly, Annually	Quarterly	2.42% - 6.72%+
Maryland	Daily, Monthly, Quarterly	Quarterly	2.3% - 5.1%
Maine	Quarterly, Semi-Weekly	Quarterly	2.19%
Michigan	Monthly, Quarterly, Tied to Fed	Quarterly	2.7%
Minnesota	Tied to Fed	Quarterly	Industry Based
Missouri	Monthly, Quarterly, Annually	Quarterly	2.511%
Mississippi	Accelerated Monthly, Monthly, Quarterly	Quarterly	1.2% - 1.4%

State	SIT	SUI	New Employer Rate
Montana	Semi-Weekly, Monthly, Annually	Quarterly	1.18% - 2.38%
North Carolina	Semi-Weekly, Monthly, Annually	Quarterly	1%
North Dakota	Quarterly, Annually	Quarterly	1.13% - 9.97%
Nebraska	Monthly	Quarterly	1.25% - 5.4%
New Hampshire		Quarterly	1.7%
New Jersey	Weekly, Monthly	Quarterly	2.9825%
New Mexico	Accelerated Monthly, Monthly, Quarterly	Quarterly	1% - 1.06%
Nevada		Quarterly	3%
New York	Daily	Quarterly	4.025% + .075%
Ohio	Semi-Weekly, Monthly, Quarterly	Quarterly	2.7% - 5.6%
Oklahoma	Semi-Weekly, Monthly	Quarterly	1.5%
Oregon	Tied to Fed	Quarterly	2.1%
Pennsylvania	Semi-Weekly, Monthly, Semi-Monthly, Quarterly	Quarterly	3.8% - 10.5924%

State	SIT	SUI	New Employer Rate
Puerto Rico	Semi-Weekly, Monthly	Quarterly	3.3%
Rhode Island	Weekly, Monthly, Quarterly	Quarterly	1.19%
South Carolina	Monthly, Tied to Fed	Quarterly	.45%
South Dakota		Quarterly	1% - 1.2% +.55%
Tennessee		Quarterly	2.7%
Texas		Quarterly	2.7%
Utah	Monthly, Quarterly	Quarterly	Industry Average
Virginia	Semi-Weekly, Monthly, Quarterly	Quarterly	2.53%
Vermont	Semi-Weekly, Monthly, Quarterly	Quarterly	1% - 4.2%
Washington		Quarterly	Industry Average
Wisconsin	Monthly, Semi-Monthly, Quarterly, Annually	Quarterly	2.9% - 3.25%
West Virginia	Monthly	Quarterly	2.7%
Wyoming	Quarterly	Quarterly	By Class Code

Payroll Setup



10 Steps for Setting Up Payroll

1. Obtain an EIN.
2. Apply for state and local Tax ID Numbers. This includes a state unemployment tax ID, if required in the state.
3. Set up a payroll bank account.
4. Decide on a payroll schedule. Common schedules include weekly, bi-weekly, semi-monthly, and monthly. Some states may require specific frequencies under different circumstances.
5. Get a workers' compensation insurance policy.

Steps Continued...

6. Determine what optional employee benefits you'd like to offer and what portion of costs will be deducted from employee paychecks.
7. Collect your employee information: name, start date, social security number, date of birth, compensation details, Form I-9, Form W-4.
8. Classify your employees into independent contractor vs. employee and exempt vs. nonexempt.
9. Chose a pay period.
10. Manually calculate your tax requirements per employee.

How frequently do you form new entities or file reports for existing entities?

- 0-4 times per year
- 5-10 times per year
- 11-20 times per year
- 20+ times per year



**Polling
Question #3**

Payroll Processing



Payroll for Traditional Employees

1. Calculate payroll, taxes, and voluntary deductions
2. Pay employees via checks or direct deposit
3. Record payroll transactions
4. Report taxes to state and federal authorities
5. Remit payroll taxes to tax agencies and benefit providers

Owner Payroll Options

Business Entity	Taxable Distribution	Salary Option	Reasonable Compensation Applies	Owners Draw Option
Sole Proprietorship	Yes			Yes
Partnership				
Single-Member LLC	Yes			Yes
Multi-Member LLC	Yes			
S Corporation	Yes	Yes	Yes	
C Corporation		Yes	Yes	

Owner Payroll for Sole Proprietorships and Limited Liability Companies

1. Take a draw from the company:
 - Write a business check in the name of the owner
 - Transfer funds from the business bank account to the owner's personal bank account
2. Record owner draws in the company's accounting software
3. Calculate and report self employment taxes
4. Calculate and report business income via Schedule C (Form 1040), Profit or Loss from Business

Owner Payroll for S Corporations and C Corporation Shareholders

1. Set a "reasonable salary" for shareholder/employees
2. Calculate payroll, taxes, and voluntary deductions
3. Pay employees via checks or direct deposit
4. Record payroll transactions
5. Report taxes to state and federal authorities
6. Remit payroll taxes to tax agencies and benefit providers

Helpful Resources



CorpNet Tools Are Your Resources

- Business Name Search Tool
- Interactive Business Structure Wizard Tool
- Compliance Portal With Monitoring and Proactive Alerts
- Annual Meeting Minutes Services
- Business Guides and Checklists
- The CorpNet Blog



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Would you like to learn more about working with CorpNet?

- Yes, I am interested in possibly using CorpNet within my organization
- Yes, I am interested in learning more about CorpNet's partner program
- Not at this time



**Polling
Question #4**



Have Questions?

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