Benefits of a C Corporation

I was recently reading Incorporate and Grow Rich, a book which I'll review in a separate post. The more I read the more excited I got about C corporations and their benefits. Then I started realizing that there were specific rules that kept me from using a C-corp for just about anything I could use it for. Once I got over the disappointment, I decided I'd share a few things about C-corps that you may not know.

You Don't Have To Incorporate To Go Into Business

Many people don't realize that being self-employed, or going into business, doesn't require you to incorporate at all, much less start a C-corp. You can just be a "sole proprietor." It is quick and easy. This blog is currently a sole proprietorship. It provides no asset protection benefits (my business is the same as me) and I do my taxes for the business on my personal tax return (Schedule C.) You can also be in business as a partnership, as many doctors are. Again, no asset protection benefits (in fact you take on additional liability due to your partner's actions), and you do your taxes on your own 1040 (Schedule K-1.) Many of the tax breaks available to corporations are available to you as a sole proprietor. You get to deduct all your business expenses and travel from your profits, and then pay taxes on the difference.

You Don't Have To Form A C-Corp In Order To Incorporate

There are other corporations that provide asset protection benefits to you, such as an S-Corp, Limited Liability Company (LLC), or, in some states like mine, a professional corporation designed specifically for doctors and lawyers. All of these are separate entities from you individually. That protects you from liabilities associated with the business, and protects the business from your liabilities. But tax-wise, these are all very similar to a sole proprietorship. They are "pass-through entities" and you end up paying tax at your personal tax rates. There is an opportunity to get out of some of your payroll taxes by incorporating yourself as an S-Corp, but that's about the extent of it. Tax-wise, these corporations are pretty much the same thing as you.

A C-Corp Pays Its Own Taxes

A C-Corp, however, pays taxes completely separate from you. It even has its own tax brackets. Here they are:

15%	<$50K
25%	$50-$75K
34%	$75-100K
39%	$100-335K
34%	$335K-$10M
35%	$10-15M
38%	$15-18.3M
35%	>$18.3M

Weird huh. It doesn't make much sense to me either. But there are some real benefits available there. Let me see if I can illustrate them. Imagine you make $450K. I know. You don't. Neither do I. But let's just imagine it. On that last $50K you made, you paid 35% in federal income tax, let's say 5% in state tax, and 2.9% in Medicare tax. That's 42.9%. If you could somehow have gotten your corporation to make that dollar, instead of you, it is possible that you would only pay

15% tax on it. That would save you 0.429*$50K – 0.15*$50K = $13,950 in taxes. Excited yet? Yea, I was too.

Avoiding Double Taxation

The problem now is that the money belongs to the corporation, not you. You can't just go blow it on a new car or a vacation. Or can you? At this point, you have a few more options available to you. First, you can have the corporation buy the car or the vacation. Of course, you have to be able to justify it as a business expense. But a CME trip would qualify (unless it's a foreign cruise), as would a car (actually the rules pretty much require it to be a truck if you want it to be new) used to commute you around to your various work sites (again, this gets tricky for a doc without any other business interests).

A better option might be that the corporation can pay you the money and you can buy the car or the vacation yourself. It can do this several ways. First, it could provide you a retirement account of some kind, such as a profit sharing plan. Now, you can take the money you would have put toward retirement and buy a car with it. The retirement account contribution is deductible to the corporation, just like it would have been to you.

Second, the corporation can pay you a salary. This salary is totally deductible to the corporation. Of course, it is fully taxable to you, including payroll taxes. That kind of defeats one of the purposes of the corporation, but at least you get the money out and can get that Geo Metro you've had your eye on. Even if it is paid as a bonus, you still pay your full marginal tax rate including payroll taxes on it.

Third, you can endure the double taxation problem. Corporate dividends to you are taxable at capital gains rates, currently 15% for most docs. Unfortunately, those are not deductible to the corporation. So the corporation pays taxes at 15%, then you pay taxes at 15%. 30% is better than 42.9%, but still not great.

Fourth, the corporation can buy you a tax-deductible (to the corporation) benefit you may want . For example, a term life insurance policy up to a face value up to $50K is deductible to the corporation. So is health insurance (including dental, vision, and a Flex Savings Account), up to $5K in child care, educational assistance up to $5250, moving expenses, a "physical fitness facility", and "de-minimis fringes" (drinks in the fridge and other small value items).

Fifth, the corporation can give achievement awards. Each year the corporation can give a fully tax deductible (to you and the corporation) award for longevity and one for safety up to $1600 each to your family member or other employee, or a $400 "non-qualified" award to you. If you make the award golf clubs or a TV you don't even have to pay payroll taxes on it. There are a few small catches, and it isn't much money, but it is a tax-free way to get it out of the company.

Sixth, the corporation can buy something from you. Sell the corporation a computer, a car, or some other equipment. It's an expense (and thus deductible from profits) for the corporation, and you don't have to pay taxes on it either (unless you somehow managed a capital gain on it.)

Seventh, the corporation can give "business gifts." These can be up to $75 per recipient per year. There’s supposed to be a business purpose, but that can be as simple as “building goodwill.” In fact, if you put your logo on it, it’s advertising and doesn’t count against the $75 limit. I’m not sure I’d try buying your employee spouse a new Mercedes with a tiny business logo by the license plate and call it an advertising expense, but there’s clearly plenty of gray in this area.

Now, most of these corporate benefits are just as available to an S Corp as a C Corp (except the dividends taxed at capital gains rates and the achievement awards given to corporate shareholders).

Reduced Dividend Taxation

There is one other huge benefit available to a C-Corp that initially got me super excited. Dividends the corporation receives from other corporations are mostly non-taxable (up to 20% may be taxed.) That sounds an awful lot like an extra tax-protected retirement plan to me.

Change Fiscal Year End

The C-Corp is also the only entity that can have a different year end than December 31st. This allows for great flexibility and some unique tax strategies that can allow you to defer taxes for up to a year. Not to mention you can get a lot more attention from your accountant in June than you can in April.

Now that I’ve got you all excited about C-Corps, I’m going to use the next post to dash your hopes, and show you that the government not only hates doctors, but also only wants real businesses to be able to benefit from incorporation.

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