

New proposed S Corporation tax bill, H.R. 4213, Sec. 413

Congress is considering taking away the employment tax benefits of being an S Corporation for certain small professional services businesses. If the bill becomes law it would be effective for tax years beginning January 1, 2011.

Social Security taxes are imposed on compensation and self-employment income up to the Social Security Wage Base (currently \$106,800) and the Medicare tax is imposed on all self-employment and compensation income. Some service professionals have been avoiding Medicare and Social Security taxes by routing their self-employment income through an S corporation. These taxpayers then pay themselves a nominal salary and take the position that the remaining earnings are exempt from employment taxes. A provision passed by the House would address this abuse in situations where (1) an S Corporation is a partner in a professional service business or (2) an S Corporation is engaged in a professional service business that is principally based on the reputation and skill of 3 or fewer individuals. The bill would classify all of the net business income from these S Corporations as net earnings from self-employment.

What does this mean for your medical practice? If your practice is currently operating as an S Corporation you may want to consider converting to a C Corporation later. Another disadvantage of operating as an S Corporation is California assesses a 1.5% tax on the net income of the corporation, which can be significant. Although operating as a C Corporation entails much more tax planning, particularly at year end, the advantages also include more allowable fringe benefits to shareholder employees.

<http://www.govtrack.us/congress/billtext.xpd?bill=h111-4213>