

# **Avoid An Audit! Become An S-Corporation!**

## **7 Reasons Why An S-Corporation Will Help Audit Proof Your Tax Returns**

**By Theodore D. Lanzaro, CPA**

Many business owners believe that the best way to avoid paying excessive taxes is to exaggerate their deductions or to not declare all of their income. **WRONG!!** In fact, these are the “RED FLAGS” that often trigger the Internal Revenue Service to audit your tax return to begin with. What a nightmare! An “audit” by the Internal Revenue Service or State Tax Authority can be a painful, time-consuming, money draining event that all business owners should be happy to avoid.

The best way to audit-proof your Form 1040, U.S. Individual Income Tax Return, is to remove as much information from it to another area where the chances of getting audited are greatly diminished. Typically, small business owners are steered to the single member LLC by an attorney. However, these attorneys are not doing their clients any favors and in most cases are forming an LLC simply because they heard everyone else is doing it.

Here’s a fact. Small business owners are open to greater audit risk. If they are using a business entity such as sole proprietorship or single member LLC that requires them to report all of their income and expenses on Schedule C of their individual income tax return, they are exposing themselves to maximum audit risk. How can this be avoided?

### **S-CORPORATION!**

#### **Here’s the information that your attorney doesn’t know to tell you! 7 Reasons why most small business owners should be operating as an S-Corporation:**

1. Your annual net income from your S-Corporation appears on one line of Schedule E of your 1040. Accordingly, there is no income or expense detail showing up that would trigger a “red flag” like there is on a Schedule C used for a single member LLC.
2. There is no disclosure of home office expense similar to that used on a Schedule C. On an S-Corporation tax return, home office expenses are combined with other expenses and no separate disclosure is required.
3. If you are a subcontractor for another business, use of the S-Corporation will help you avoid being issued a 1099-MISC which detailed the income you received from the other business. As a sole proprietor, that 1099-MISC is sent to both you and the Internal Revenue Service giving them an opportunity to match-up your income.

4. The typical “red flags” such as travel, entertainment, and automobile expense receive less attention on an S-Corporation return because the audit rate for S-Corporations is substantially lower than that for individuals.
5. The Internal Revenue Service is paying less attention to S-Corporation returns currently because of the limited number of auditors they have. Most of the audit resource for corporations is being directed towards big corporations because of the opportunity to extract larger amounts of tax dollars.
6. You can substantially reduce the amount of FICA taxes paid with an S-Corporation. A LLC requires that the owner pays FICA taxes on all of the net income. An S-Corporation is allowed to pay its shareholders a reasonable salary and the remainder of the net income can be taken by the shareholder free of FICA taxes. **The savings to a small business owner of a profitable company can be thousands!!**
7. It is easier for an owner of an S-Corporation to sell the business because there is no corporate level tax to be paid upon the sale similar to a C-Corporation.

To summarize, small business owners who are currently organized as an LLC or a Sole Proprietor can reduce their risk of a painful Internal Revenue Service audit and save a significant amount of taxes by switching to an S-Corporation.

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**You should consult a tax professional prior to implementing any of the tax planning strategies to make sure it fits your specific situation.**