(auto-translated)

Matt Robison 00:00
Hey Mike, you ever set yourself up for some payback?

Mike Morton 00:04
No. Why do I do that? What kind of payback?

Matt Robison 00:08
These are the questions I'm asking myself because apparently that's what I did to myself, and you're going to hear all of it here on Five Minute Finance. I'm Matt Robison, and that is Mike Morton, who's about to administer the pain. He usually administers practical, easy to implement steps that you can use to lighten your load, take things off your to-do list, and get you on your way. Make your financial life and your whole entire life easier. But no, today I've hoisted myself on my own petard. Not entirely sure what a petard is, but I've hoisted myself on one, and Mike is going to give me some comeuppance. Here's what happened back in episode 195, titled "Navigating Tax Season: Top 10 Smart Saving Tips for 2026. A listener wrote in, "Transitioning from w2 to contracting with the same clients, expecting to make over $200,000, should they create an LLC? And I apparently said the following: I want to bookmark the idea that I want to do a deeper dive on LLCs, when to and when not to, and what the use is, because this is definitely something that comes up. Well, Mike, it's coming up, and I asked for it, so I guess I'm gonna get it.

Mike Morton 01:26
It's here. You and all the listeners are gonna get it now. When and where to use an LLC, and what that even means.

Matt Robison 01:34
All right, give me a little more. What are we gonna get into on this episode?

Mike Morton 01:39
All right, today we're going to break down what is an LLC. People say like, "Oh, yeah, you should start a business. You got to like start an LLC. So LLC, then the S corp election. That's the next thing people say. Oh, come on, you got to be an S corp. You know, you're going to save tons of money in taxes. You don't have to pay tax. You're an S corp. So what's the real thing with S corps? We're going to break down the real math, okay? In a scenario, being an S corp and not five times an LLC makes sense, and five times that it doesn't.

Matt Robison 02:09

That is a phenomenal amount of very, very useful stuff, but it's not all because there's more. You'll want to stay tuned. We've got a listener question about an $18,000 side hustle. We've got a worth knowing that is truly an astounding fact, like a a mind bending fact, and it involves Star Wars. So that's fun. And finally, we have our weekly one thing that involves doing the opposite. And George Costanza, I love every bit of it. Should we get into

Mike Morton 02:41
it? Let's go.

Matt Robison 02:42
What is an LLC? I mean, I own one, so I feel like I know the answer, and I think I'm about to find out that I really don't know the answer.

Mike Morton 02:51
LLC is a limited liability company. LLC created by state law. You can register with your state to create this company. The one thing it does is help shield you from lawsuits. Okay, so that's the limited liability company. So someone decides to sue you for the work you're doing as part of your company. It's harder to break through to your personal assets, to your kids' five to nine, to your brokerage accounts, checking and savings accounts. You know, hopefully the lawsuit stops at the LLC, the limited liability company. Here's the one thing it does not do, Matt. It does not change your taxes at all. Okay, it has nothing to do with taxes. It's a limited liability company that helps shield you from lawsuits, all right, does not change your tax situation at all.

Matt Robison 03:46
That is a really interesting and important fact that I didn't understand until I had an LLC. I exact I formed one for exactly those purposes because I write and I podcast and I say things which a particularly difficult litigant might decide to go after me for someone whose name rhymes with Donald Trump, for example. You know, you could have a vexatious litigant who decides to sue you, and it is apparently, according to my lawyer friends, a very big deal in legal terms to pierce the veil of a corporate shield that's supposed to be around. Like I am doing my work through the corporation, through the limited liability corporation. It's right in the name, you know. There is limited liability for me, and I like that. But yes, I I was shocked to discover that I got no tax benefit from it, and my taxes were still as high as ever. So that was a bummer.

Mike Morton 04:51
There's no tax benefit, and the and the corollary here is you could have a business without an LLC, so you don't need like to have business and. Pursue business and have business income has nothing to do with having an LLC. All right, and so five minute task. If you want to find out you have business income, pull up your tax return and look for Schedule C. And if you have a Schedule C, congratulations, you have business income in terms of the IRS. You got to do the

S corp, S corp thing. Okay, so an S corp is nothing to do with the corporation. Actually, it's a tax election for your LLC. Okay, so you have an L. Maybe you have an LLC. You've created one. Decide you know I need an LLC. I want to be. Not only do I want to be in business, but I also want to have an LLC. The two are separate. You don't need an L. We just said we don't need an LLC to be in business. Okay, so now you decided like I want a limited liability company. You can make an election to be taxed as an S corp. Now what this does is it splits your income into two buckets. Previously, if you just own a business, sole proprietor business, or a single-member LLC business that shows up on Schedule C, all the income from your business just flows through as income to you on your tax return. Super straightforward. Make 18,000 bucks on a side hustle. That's 18 grand of income. You owe tax on 18 grand of income, just like you owe tax on your w2 income. It's exact. It's taxed exactly the same way. Don't they even call it a pass through LLC? Yeah, LLC. Yep, shows up on Schedule C. It just, I mean, it's just so straightforward. Okay, it's and that's good. That's good news. It's like okay, it's just all kind of income. All right, the S Corp election splits it into two buckets. All right, you pay yourself a w2 salary, and that's just like income, but it has to be w2 salary. And I'll explain a little bit about that. And then the second piece is a distribution, just a straight up distribution. So those are the two income sources. So you make 18 grand, maybe it's 10 and 810. grand is my w2 salary. Eight grand is my distribution. Okay, w2 salary is what gets hit with payroll taxes. So you pay payroll taxes on the w2 salary. Okay, self employment tax, payroll taxes, FICA taxes, social security taxes. These are all income taxes, all paid on your w2. You have to run payroll. You can just run it once a year. You can run it monthly, but you have to run payroll when you're an S corp. Pay the payroll taxes, the w2 salary on the 10 grand. The other eight grand just flows to you as a distribution. It's taxed differently. Okay, so it does not pay the Social Security, the FICA taxes. Is

Matt Robison 07:38
differently a euphemism for less.

Mike Morton 07:42
Yes, it is taxed less, but they're okay. So then we're gonna get to the real math. It is taxed less, and so immediately you're like, "This is great. This is great. I need I need myself some split income. I need these distributions to to pay less tax, and that's what you'll find is the immediate response and why people promote doing an S corp.

Matt Robison 08:03
I see. All right. So here's what I've gotten so far: all LLCs are businesses. All businesses are not LLCs. An S corporation is not a corporation. It is a way of paying your taxes differently, and it's like one of those medicine commercials. You might need to ask your doctor or your financial planner if an S corp is right for you.

Mike Morton 08:30

That's you got it exactly right so far. That's right, an S corp. And to be clear, the S corp is an election you make for your LLC to be taxed as an S corp, so you got it exactly right.

Matt Robison 08:43
All right, so can we walk through then, like, what's a scenario where you know what would it look like to elect to be an S corp, and and like why one might choose to do this?

Mike Morton 08:55
Here we go. Say you have 150,000 of business income. 100. That sounds

Matt Robison 09:00
awesome

Mike Morton 09:00
of profit. Well, I'm going to say profit, even like this is your salary. You're running a real business, and you're you know you got a gross income of you know a couple 100,000, but you got expenses of 100,000, and so your profits 150 grand. That's what's flowing through to you as income. Okay, so the LLC, single member LLC, or even just sole proprietor. We said you don't even have to have an LLC. Very simple: 150 grand of income you're going to pay self-employment tax, social security, Medicare tax. The total is going to be about 20 grand of of those taxes, not income tax, self-employment tax, social security tax, Medicare tax.

Matt Robison 09:41
All right, 150,000 net profit with all of those taxes included, about 20 grand,

Mike Morton 09:50
20 grand of tax. Okay,

Matt Robison 09:51
okay.

Mike Morton 09:52
Now, if we split it, you say, you know what? I'm going to be an S corp. I'm going to make the S corp tax election for my LLC. I'm going to pay my. 90 grand of salary, w2 of 90 grand, and the rest, the other 60 grand, is a distribution. Okay, simple math. You're only going to pay 13 grand of those taxes I mentioned instead of 20. So therefore, you get seven grand, $7,000 extra in your pocket because it was not taxed.

Matt Robison 10:26
Ah, that sounds good.

Mike Morton 10:30
That sounds awesome. All right, if you so if you're but everyone

Matt Robison 10:33
doesn't do this, and there must be a reason.

Mike Morton 10:36
Well, hold on a sec. Everyone doesn't do it because a they haven't heard about it. That's why you. That's why it's all out there, and you're like, oh, you got a side hustle, you got to make the LLC, you got to do the S corp. Here's why: if you're the rule of thumb is like you're generally above 100 grand of net profit, that's kind of a cutoff. Like, hey, you got to have some stuff. If you're generally in there, like you're going to save 7000 bucks in tax. That's an extra $7,000 in your pocket. That's the simple math, okay. However, that's not the whole story.

Matt Robison 11:06
All right, give me give me the bad news.

Mike Morton 11:08
Okay, what they're not talking about there's a couple of things that they're not talking about there. Okay, one is the cost for to do this to make the escort. There's compliance. All right, I told you that you have to run payroll. Okay, that's a cost. So you got to run payroll. You've got to keep your books. You got to have a bookkeeper. There's like you know you're in business, so hopefully you're doing some of these things, keeping track of your income and expenses and stuff. But when you do the S corp election, you've got to file an 1120. So you're paying a tax preparer to do that. You've got to run payroll. That might you know I use Gusto. It's like 40 bucks a month, so there's a cost to that. So there's costs of maybe 1500 to 3000 bucks a year, like extra cost to be able to do this compliantly.

Matt Robison 11:51
Got it. Got it. So that's that's number one. You said costs, right? So now I'm suspecting here's

Mike Morton 11:57
one. So that's 7000, but now we're down, you know, a couple 1000 off of that because we got to have these compliant costs. The other is the QBI. Now QBI is complicated. That's qualified business income, all right. But qualified business income, it takes it off of the. If you're paying yourself the distribution, you're getting less QBI. That's what it boils down to. When you've split your income, now we've got some w2 income and we got some distribution income. You've reduced the 20% QBI that you're allowed. That you that in the single member LLC you could take the whole 150 grand and have a QBI 20% of that that you're not paying tax on. Okay, that's

the second big cost here. You've now split your income, lowered your QBI deduction by another few $1,000.

Matt Robison 12:49
So you add up number one and number two, and you were talking in your initial scenario about saving 7000 bucks. Sounds like most of that evaporates.

Mike Morton 12:58
Yep, you're down to like one or 2000 bucks at this point. That's right.

Matt Robison 13:02
Wow! And you've done a whole bunch more stuff.

Mike Morton 13:05
Yeah, you've had to do the stuff, time and energy. You know the compliance. You know running the payroll, keeping track of all the stuff. And then when you come to the QBI, you realize like, oh, I was getting your previous tax return had like a 15 grand deduction. You you where you get tax free? That's the QBI is like tax 20% tax free coming straight to you. But you reduce that, and you didn't realize it by doing this S corp election. You reduced that deduction drastically, and so left in your pocket, it's not seven grand. It's like one grand.

Matt Robison 13:36
I'm smelling a rule of thumb here. There's got to be a simple five-minute way of trying to say our S corps right for you.

Mike Morton 13:47
Yeah, it's a pretty tough one. I mean, the five-minute task here-you pull up your Schedule SE on the last year's return, and it's self-employment tax. That's where you save a lot. And so, if that single number in the the self-employment tax. If it's under 10,000, then this is probably not worth it. Okay, got it. If that self-employment tax number is getting pretty high, I use the rule of thumb that we'll start running these scenarios. Should I be an S? You know, do the S corp election or not? I started sort of over 100 grand of income. You need that. But as we just mentioned even with 150 grand of income, might not be worth it. You say, I mean, you save 1000 or two, a couple 1000 bucks, but you got to decide if it's going to be worth it for you.

Matt Robison 14:30
Well, that's awesome. Again, just kind of resetting because I've learned several really useful things here. One is this whole like what an LLC is and isn't, right? And so you have kind of gate number one to pass through of should I have an LLC that has nothing to do with your tax liability; it has everything to do with legal protection. So that's one set of questions. Then there's a second

set of questions about should I do this election as an S corp? So. I'd like to do what we kind of teased at the top here and talk about the circumstances under which we should walk through that first gate and create an LLC.

Mike Morton 15:10
Cool. Yeah, let's do it. Five reasons, five times that an LLC might make sense for you. All right. The first is that you you mentioned, hey, I have real liability exposure. You know, like, hey, I'm I'm creating content that might upset some people. You know, I could get sued. I'm creating products that could injure somebody, and some, you know, it might probably won't, but it could injure somebody, and I could get sued. So if you have real liability exposure, I'd go with the LLC. There's a downside to creating LLCs, Matt. They actually cost money. Like I

Matt Robison 15:45
know, every year. I I discovered this to my great consternation the first time I created an LLC, and I discovered it's $500 a freaking year in Maxsachusetts, and I was like, I I'm not sure that like my risk of getting sued is that great. This was like before the Trump era, so now I think my risk of getting sued is very very high. But yeah, I mean it's it's not nothing.

Mike Morton 16:13
That's correct. It's not nothing. So anyway, yeah, if you got liability exposure, that's number one. Number two, rental real estate. Okay, if you have one property and you rent it out now and then, maybe not a big deal. But if you're in, you know, hey, I'm, you know, kind of like have this property that's full time, a rental, you know, income producing property. I'd like to get a second one. Those are situations that's really worth having each of them in their own LLC. If you've got like two or three rental properties, creating an LLC for each one. Again, it's for the liability, but it's nice to keep those things separate from each other.

Matt Robison 16:48
Right, and that way, if you run into a legal problem with one, I'm suspecting that the the reach wouldn't extend to another property.

Mike Morton 16:57
That's exactly right. Because the assets are

Matt Robison 16:58
just the single property.

Mike Morton 16:59
That's right. Now again, downside 500 bucks per LLC per year.

Matt Robison 17:04
Right.

Mike Morton 17:04
Okay. I mean, so there are downsides to these things, but they're you know it's it's for the liability. You know, it's for that protection. It's

Matt Robison 17:10
like the same calculus you make when you buy insurance, right? It's it's a risk adjusted expected value, and that's exactly that makes a lot of sense. All right.

Mike Morton 17:18
Yep. If you've got a partner, you know, spouse or a partner, and you want to protect them. You know, hey, they're in some some field, or you know, they've got money or some assets. That's another reason to have LLCs. Number four, your clients require or expect it. You know, who you're working for. You know, they need. You know, hey, I'm in the home construction. You know, business. Well, I expect you to have some liability protection in case something falls on the work just site, you know. So if your clients expect it, then you really you know need to have that liability protection. And then finally, number five, we talked about if your profit's high enough that you want to look at that S corp election, then you need to be an LLC because you can't do that on just a sole proprietor.

Matt Robison 18:01
Let's talk about the S corp side of this first. You want to do when the LLC does not make sense.

Mike Morton 18:05
That's correct. Yeah, S corp. We kind of gone through, so hopefully people have a good sense of that. Again, I use the rule of thumb around 100 grand when you're reaching that. It's like, hey, you know. And there's the we haven't even talked about the making the reasonable salary, and the IRS would come after you for that. So there's there's a lot to work through when it comes to S corps, but today's episode is really just kind of what it is, when to start paying attention. All right, five times you probably don't need an LLC. All right, if your side hustle is small, you don't need an LLC. I mean, if you know if you don't really have the liability and you're making 10 grand, 20 grand, why go through all the headache of of paying a yearly fee for the LLC and the paperwork and stuff, just not worth it. Okay, so if your side hustle is small, don't even don't even worry about it. Number two, if you're trying to do it to lower your taxes, we already just said like bad news, brother. Bad news. LLC isn't going to do anything for your taxes. Okay, so if you're like, oh, I need an LLC because it's going to help with taxes. Nope, nope, you do not need an LLC. It is not going to help you. Sorry. All right, number three, you're a w2 employee hoping to write off some personal expenses through your entity. Nope. Unfortunately, you cannot. If you're

a w2 employee for a job, you cannot also write off other expenses related to that w2 job. Doesn't work that way. LLC will not help you whatsoever. You can get Matt. I talked about this earlier. You can get insurance coverages for your business that aren't that don't have to be for an LLC. You can have a sole proprietor business. You got the Schedule C by default. That's what you are. If you have you know you make 10 grand off Etsy, it shows up on your Schedule C. You got to give it a name for what your company is. You can still purchase insurance. Okay, so if like insurance will help cover you, or you know you need a subcontractor, like hey, you need this insurance. You don't have to get an LLC to do that. You can buy insurance for your business.

Matt Robison 19:56
So for example, if I'm selling something on Etsy, like. A glass baby toy, and I decide I'd rather just get the insurance, so I'll have a lawyer show up and defend me. I don't need an LLC for that.

Mike Morton 20:08
That's right. By the way, it's not an either or, right? You can get insurance without the LLC. You can get insurance with the LLC. Okay, so it could be both. Then number five: if you won't actually maintain it. Do not start an LLC. You have to file paperwork every year. You got to pay 500 bucks if you're in Massachusetts, 800 bucks if you're in California. Check out your own state where you are. If there's yearly fees, what you need to file with the state every year to maintain that you still have your corporation.

Matt Robison 20:38
Yes, that's that one again. Like when I first started, when I first started out as a writer, and I was getting paid, I was like, "Oh, I'm not writing that often. Like this is a lot. Let's let's not anyway. And then later, I made more, so it made more sense. And just finally, again, the S corp thing here. Just just walk us through the recap of when does it not make sense? Like just as they stop, don't walk through that gate.

Mike Morton 21:08
Yeah, totally. If you're under 100 grand, I wouldn't. I wouldn't worry about it. I wouldn't bother. It's not going to save you on taxes. Going to be a lot of headache. So wait until you cross the 100 grand threshold of profit. If you have lumpy, unpredictable income, that could be another reason to not like. Hey, I I made I made 110 grand last year, but this grand maybe only four this year maybe only 40 grand. All right, it's not going to be worth it because you got to pay like that w2 reasonable salary. The last point is actually your if you're maxing out your solo 401k. If one of the reasons you love having a side hustle with like 110 grand is because you can max out your solo 401k. If you go S corp, it it might actually lower the amount that you can put into your solo 401k.

Matt Robison 21:53

Oh, that's so. So it's another

Mike Morton 21:54
gotcha. Like yeah, yeah, got it on a bunch of stuff here when you're looking at S corp election versus not. So, if the solo 401k is important to you, that's a way of maximizing shoving money in there. Just make sure you take a hard look at that.

Matt Robison 22:08
All right. Well, that is great. I think we're ready for our highly related listener question. Should we do it?

Mike Morton 22:14
Let's go. All

Matt Robison 22:15
right. Once again, you've been sitting on this one like a mother hen with an egg, and it is ready to hatch. And I will give the standard disclaimer that if you're a client of Mike's, you can contact him with your questions any time via any method you like. I suggest semaphore. Semaphore. It's like the Morris dancing of communications. It was out like 300 years ago, but whatever. People still learn it and use it. And if you don't know what it is, Google it, and people think you're a maniac. Meanwhile, for the rest of us, you can email pod@mortonfa.com. This week's listener question: I have a full time w2 job, and I make about $18,000 a year consulting on the side. Spicy. A friend who owns a business told me I'm crazy not to have an LLC and an S corp, he said. I could write off my home office and part of my car. Is he right? So I assume that your friend is me, and I am selling bag of glass baby toys. In which case, I should not have an LLC.

Mike Morton 23:15
Yeah. Hopefully now you can answer this question. Don't even need my answer. Yeah, your friend is is very very generous, but wrong on both accounts. We've already talked about you know if the income's not that high, the S corp is not going to save you on taxes. And then on the write-offs part, you don't need an LLC or an S corp to be able to write off business deductions. You can just be a sole proprietorship, which is again default if you don't, you know, make any, you know, company S corp, C corp, LLC, whatever, and you can still write off home office and mileage expenses and computer expenses and other reasonable expenses for your job.

Matt Robison 23:57
Let's do our one thing. You want to suggest sitting around and being lazy, I love it. I'm in. Tell me more.

Mike Morton 24:04

Yeah, sit back, relax, do nothing for the next three hours.

Matt Robison 24:08
Fabulous. This is like your advice to go walking without headphones and get attacked. Walk there without

Mike Morton 24:13
headphones and sit around and do nothing. These are great. This is the not doing list. I love this idea. Do you always have this sense of like you're kind of making these decisions, you know. You're always making decisions on where to spend your time and energy, and like, okay, I got to do this thing. I got the got the to do list. But then there's a lot of things you're like, no, I'm not going to do that. Like, oh, I was asked to you know be on this this you know parent teacher, the the parent classroom, you know, for my kid, and I'm like, no, I just I'm not going to do that. You know, or I was asked to be on this board, and I'm not going to do that. I've asked to coach this team, not going to do that. I was asked to be on this thing at work, I'm not going to do that. And then they keep they sort of keep coming up. It's like bubbling in the background. Oh yeah, yeah, that thing's coming around again or whatever. So I think you should have the not doing list. You should write down all the things you're like. You know what? I'm not doing this because it's more important. I do spend my time and energy doing these other things, and then when things come around again, and they're asking you again, like, "Oh, you know, can you volunteer for you? Like, it's on the not doing list. I don't have to like give it any time and energy. I've already made a decision to not do this.

Matt Robison 25:16
So these are things that you have a genuine dilemma about, not problems to avoid in life, like I'm not going to wrestle a Jaguar tomorrow.

Mike Morton 25:24
Not things that are obvious, Matt.

Matt Robison 25:28
Well, you don't know how I live. Let's get to our one are worth knowing. Right, this one just stopped me in my tracks, man. I the floor is yours, and this is about Star Wars. Amazing

Mike Morton 25:40
LLCs. Did you know that LLCs are younger than Star Wars?

Matt Robison 25:45
I assure you, I did not.

Mike Morton 25:47
Everybody just LLC was like, "Oh, dude, you got to have an LLC. You know, like it's like it's been around forever. It was invented in 1977 in Wyoming, of all places. It was signed into law in march 4 of 77, and it wasn't even a grand like policy vision. It was lobbied by one single company, Hamilton Brothers Oil, which wanted some liability protection. I can't imagine why they're making oil. This is just literally the first time I told you it's state law. So LLCs are state laws in 1977, and the last state to catch on was Hawaii in 1996. Wow! I mean,

Matt Robison 26:30
that really is like I just think of them as sort of a fact of life, like taxes or hangnails or the Red Sox finishing in last place, and yet here we are. So for Mike, I'm Matt. We'll see you next time.

Mike Morton 26:47
Thanks, Matt. Thanks for joining us on Five Minute Finance. If you like what you heard, please subscribe to and rate the podcast. It makes a huge difference for my show. You want more? Find Morton FA on Substack. If you have a comment or question, please email pod@mortonfa.com. Until next time, thanks for tuning in. This recording is for informational purposes only and should not be considered for investment advice. Opinions expressed are as of the date of recording. Such opinions are subject to change. I cannot guarantee the accuracy or completeness of the data presented here.