

Social Security and Medicare Taxes

On Wages

	<i>Employer</i>	<i>Employee</i>	<i>Total</i>
Social Security	6.2%	6.2%	12.4%
Medicare	1.45%	1.45%	2.9%
Total	7.65%	7.65%	15.3%

Personal exemption: None

Social Security wage base for 2016: \$118,500

Medicare surtax: 0.9% of wages, compensation, and self-employment income greater than \$200,000 (single), or \$250,000 (married, joint return)
- employee only - combined with regular Medicare tax, rate is 3.8%

On Net Earnings from Self-Employment

Social Security	12.4%
Medicare	2.9%
Total	15.3%

Tax base: 92.35% of net earnings from self-employment

Filing threshold: \$400 of net earnings from self-employment

Social Security base for 2016: \$118,500 minus wages

Medicare surtax: 0.9% of wages, compensation, and self-employment income greater than \$200,000 (single), or \$250,000 (married, joint return)
- combined with regular Medicare tax, rate is 3.8%

Tax on Net Investment Income (~Medicare)

3.8% of net investment income

Applicable only to extent adjusted gross income is greater than \$200,000 (single), or \$250,000 (married, joint return)

Applicable to investment income (dividends from C corporations, interest, recognized gains on stocks, bonds, etc.), income from financial trading business, and passive activity income (such as rental)

Not applicable to income from nonrental, non-financial-trading business activities in which taxpayer materially participates

Not imposed on wages or self-employment income

Choice of Entity Considerations

Wage tax is not applicable to partners

Wage tax is imposed on S corporation shareholders only to the extent of wages paid

Self-employment tax is imposed on pass-through income from partnership business to general partners

Self-employment tax is not imposed on pass-through income from partnerships to limited partners

Some LLC members may be treated as general partners for this purpose

Self-employment tax is not imposed on pass-through income from S corporation to shareholders

Net investment income tax is not imposed on tax-free distributions from S corporations to shareholders, or from partnerships to partners

Net investment income tax is imposed on investment income passing through from S corporations to shareholders, and from partnerships to partners

Example: Barb and Chuck are 50-50 co-owners in a law firm. Both materially participate in the law firm's business. The firm has a \$230,000 profit for the year; Barb and Chuck each take \$100,000 cash out of the firm for personal use, leaving \$30,000 of profit in the firm for expansion. Each co-owner has total income for the year of less than \$200,000.

As a state law general partnership, each would be liable for self-employment tax of \$16,249 (15.3% of 92.35% of \$115,000 pass-through income).

As a state law LLC, the results would probably be the same.

As an S corporation, if the entire \$100,000 payments were treated as wages, combined wage taxes would be only \$15,300 each (15.3% of \$100,000). If only \$90,000 of the \$100,000 distributions were treated as wages (and the rest as distributions on stock), combined wage taxes would be only \$13,770 each (15.3% of \$90,000).