How to Pay Yourself from Your Business

Salary or Dividends or Distribution? What About Taxes?

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How Business Owners Pay Themselves - and the Tax Consequences

It's common to hear business owners talk about "getting a salary" from their business, but that's not actually how most business owners get paid by the business. The word "salary" is common when talking about employees, but most business owners don't actually take a salary as an employee. How you pay yourself out of the business depends on your business legal type.

A Spreadsheet Showing How Business Owners Pay Themselves

Owner/Business Type	How Take $	Tax Return	Self-employment Tax?
Partner	Distributive share	Schedule K-1 for 1040	yes
Sole Proprietor	Draw	not on tax return	yes
Single-member LLC	Draw	not on tax return	yes
Multiple-member LLC	Distributive share	Schedule K-1 for 1040	yes
Corporate owner	Dividends	Dividend income on 1040	not on dividends
S corporation owner	Distributive share	Schedule K-1 for 1040	yes
Corporate exec/employee	Paycheck	W-2 income on 1040	FICA tax as employee

Business Owner Draw vs. Distribution

Notice the terms "draw" and "distributive share" in the table above. The difference between a draw and a distribution is significant for tax reporting purposes. A sole proprietor or single-member LLC can draw money out of the business; this is called a draw. It is an accounting transaction, and it doesn't show up on the owner's tax return.

A distribution or distributive share, on the other hand, must be recorded (using Schedule K-1, as noted above) and it shows up on the owner's tax return.

Sole Proprietors Take a Draw

If you are a **sole proprietor** you are not an employee and you don't take a salary in the form of a regular paycheck. No FICA taxes (Social Security/Medicare) are deducted and no federal or state income tax is withheld.

A sole proprietor gets "paid" by taking a distribution from the profits of the business. Amounts taken out of a business by a sole proprietor may be called a draw because these amounts draw down your capital (ownership) account. Read more about how owner's draw works.

Partners Take Distributions from Profits

A **partner** in a partnership also does not get paid a salary; they take distributions in a way similar to a Partners can take distributions from partnership profits and are taxed based on their share of those profits on their partnership income tax return. How profits are distributed in a partnership or LLC depends on the language of the partnership agreement or LLC operating agreement.

LLC Owners Take a Draw or Distribution

Owners of limited liability companies (LLCs) (called "members")are not considered employees and do not take a salary as an employee. Single-member LLC owners are considered like sole proprietors for tax and income purposes, so they take a draw like a sole proprietor. Multiple-member LLC members are considered like partners in a partnership, so they take a distribution.

Corporate Owners Get Dividends

An owner of a **corporation or s corporation** is a shareholder, and as a shareholder, he or she takes dividends when the corporation's board decides to pay them. But many growing companies don't give dividends, but put the profits of the corporation back into growth.

Corporate Owners Who Work in the Business Get a Salary

Corporate officers who are involved in the day-to-day running of a business must take a salary and employment taxes must be paid on that salary. In addition, S corporation shareholders may take additional distributions of profit from the business.

How Much Should I Take from My Business?

Business owners who take a draw or distribution of profits can take any amount they want from their business. Of course, you shouldn't take money that will be needed to pay employees, pay off business loans, or pay other bills of the business.

What's a reasonable salary for an officer in a corporation or s corporation?

Some corporations try to hide corporate officer pay to avoid employment taxes, but the IRS says corporate officers must be paid a reasonable amount.

The IRS has established guidelines for determining a reasonable salary, based on experience, duties and responsibilities, time spent, comparable amounts paid to others doing similar work, and other factors.

How does self-employment tax work for business owners?

Self-employment tax is the equivalent of FICA tax (Social Security and Medicare) for business owners. The amount of self-employment tax that must be paid is based on the profits of the business; if the business does not make a profit in any one year, no self-employment tax is due.

Owners of sole proprietorships, partnerships, and LLCs do not take a salary, so any money they take from the business does not have deductions or withholding for (1)FICA taxes (Social Security and Medicare), (2) federal income tax, or (3) state income tax. In addition, no other employment taxes are paid by the company for this distribution to a business owner.

Of course, these taxes are still due and payable. Sole proprietors, partners, and LLC members must pay self-employment tax when they complete their personal tax return for the year. The self-employment tax is calculated and added to the income tax due; self-employment taxes are paid to the IRS along with federal income taxes.

How does income tax get deducted from payments to business owners?

Since payments to business owners (not including salaries to corporate officers) are not considered payroll, federal and state income taxes are not withheld. Business owners must make quarterly estimated tax payments to avoid penalties.

For more information on how taking money from your business affects your taxes, read this article about business owner pay and taxes.