PHYSICIANS & HEALTHCARE PROFESSIONALS

Should Your Practice Elect S-Corporation Status? A Physician's Decision Framework

The election is a payroll-tax decision before it is anything else. Two income scenarios show where the line actually falls — and why $100,000 and $200,000 of practice income lead to opposite answers.

Almost every physician who steps into independent practice — whether through a professional corporation, a locum arrangement, or a side consulting entity — eventually hears the same advice: *"You should be an S-corp."* It is offered confidently, usually without a number attached to it, and it is right often enough to be dangerous.

The S-corporation election is not a status symbol and it is not free. It is a trade: you accept the cost and rigidity of running payroll, filing a separate return, and defending a compensation figure to the IRS, in exchange for shielding part of your practice income from self-employment tax. Whether that trade favors you depends almost entirely on **how much profit sits above a reasonable salary** — and for most physicians, on very little else.

Below is the framework I walk clients through, followed by two scenarios that sit on opposite sides of the line.

The mechanism: what the election actually does

A physician operating as a sole proprietor or single-member LLC pays **self-employment tax** on the entire net profit of the practice. That tax is 15.3% — 12.4% for Social Security and 2.9% for Medicare — up to the Social Security wage base, above which only the 2.9% Medicare portion (plus the 0.9% Additional Medicare surtax at higher incomes) continues.

An S-corporation splits the same profit into two streams. The physician becomes a W-2 employee of their own corporation and pays themselves a **reasonable salary**, which carries full payroll tax. Whatever profit remains after that salary is taken as a **distribution**, which is *not* subject to Social

Security or Medicare tax at all. That untaxed distribution wedge is the entire source of the savings.

> THE NUMBER THAT GOVERNS EVERYTHING
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> For 2026, the Social Security wage base is **$184,500**. Below that figure, every dollar shifted from salary to distribution saves the full 15.3%. Above it, the 12.4% Social Security portion has already stopped — so the only remaining savings on distributions is the 2.9% Medicare piece (3.8% once the Additional Medicare surtax applies).

This single fact reshapes the analysis for high earners in a way that is frequently missed. A physician with $600,000 of profit does not save 15.3% on the distribution above their salary — they save roughly 3%, because Social Security tax was already capped by the salary itself. The savings are real, but they are Medicare-rate savings, not the headline number.

The reasonable compensation constraint

The distribution wedge cannot be made arbitrarily large. The IRS requires that S-corporation owner-employees pay themselves **reasonable compensation** for the services they actually perform before taking distributions. For a physician, "reasonable" is anchored to what the market pays a doctor in that specialty and region — and physician salaries are high, well-documented, and easy for an examiner to benchmark.

This is the structural reason the S-corp math is less generous for physicians than for, say, a software consultant. A consultant might defensibly draw a $90,000 salary against $300,000 of profit. A cardiologist cannot: their reasonable salary might be $350,000 or more, which can absorb most or all of the profit and leave little room for a tax-advantaged distribution. **The higher your defensible salary, the smaller your distribution wedge, and the weaker the case.**

> A NOTE ON THE QBI DEDUCTION
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> Medicine is a "specified service trade or business" under §199A. For 2026, the deduction fully phases out once taxable income exceeds **$553,500** (married filing jointly) or **$276,750** (single). Most established physicians sit above these thresholds and receive no QBI deduction regardless of entity choice — which means, for them, QBI is *not* a reason to elect S-corp status. For

lower-income or early-career physicians who remain under the threshold, the interaction is more nuanced and worth modeling directly, because an S-corp salary can affect the deduction.

Two scenarios

WHERE THE LINE FALLS

Consider two physicians, each operating through a single-member LLC (taxed as a sole proprietorship by default), each deciding whether to elect S-corporation treatment. The figures below are illustrative and use round reasonable-salary assumptions to expose the mechanism; a live engagement would benchmark compensation to specialty and regional data.

SCENARIO A — LIKELY NOT WORTH IT

$100,000 of net practice income before owner salary

This is a physician with a modest independent stream — perhaps part-time locum work, telehealth, or expert-witness consulting alongside a W-2 hospital position. Suppose a defensible reasonable salary for this level of service is **$70,000**, leaving a $30,000 distribution wedge.

Net practice income (pre-salary)	$100,000
Reasonable W-2 salary	$70,000
Distribution (payroll-tax-free)	$30,000
Payroll tax saved on distribution (≈15.3%)	**≈ $4,590**

A gross saving of roughly $4,600 looks appealing until the costs of the structure are netted against it: a separate 1120-S return, payroll processing and filings, higher bookkeeping complexity, state franchise or entity fees, and the accountable-plan and reasonable-compensation documentation the structure demands. In California, the S-corporation also owes the **1.5% state franchise tax on net income** (minimum $800), which claws back a portion of the federal saving. Once those costs are subtracted, the net benefit is thin — and it is fragile, because a single reasonable-compensation challenge that pushes the salary higher can erase the wedge entirely.

My typical guidance at this level: stay a sole proprietor or disregarded LLC until the practice income grows. The election can always be made later, and there is little cost to waiting.

SCENARIO B — GENERALLY WORTH IT

$200,000 of net practice income before owner salary

This physician runs a genuine independent practice — an established solo or small-group arrangement generating steady profit. Suppose a defensible reasonable salary is **$130,000**, leaving a $70,000 distribution wedge.

Net practice income (pre-salary)	$200,000
Reasonable W-2 salary	$130,000
Distribution (payroll-tax-free)	$70,000
Payroll tax saved on distribution	**≈ $8,700**

Here the salary sits below the $184,500 Social Security wage base, so most of the distribution wedge escapes the full 15.3% rather than only the Medicare portion — meaning the saving lands near **$8,700** before costs. Even after the 1120-S return, payroll administration, California's 1.5% franchise tax, and documentation overhead, a clear four-figure net benefit remains — and it recurs every year the practice sustains this profit level. At this scale the structure is also more defensible: the salary and distribution both look proportionate, and the wedge is large enough to absorb reasonable-compensation scrutiny without evaporating.

My typical guidance at this level: elect S-corp treatment, pair it with an accountable plan and a properly designed retirement structure, and document the compensation basis contemporaneously.

THE ROUGH THRESHOLD, STATED PLAINLY

The federal payroll-tax saving becomes reliably worth the cost and complexity of an S-corporation somewhere around **$150,000 or more of net practice income above a reasonable salary's floor** — which, for most physicians, means total practice profit meaningfully north of $150,000. Below that, the costs and audit exposure tend to swallow the benefit. This is a starting point for the conversation, not a formula; the right answer depends on your specialty's compensation benchmarks, your state, your retirement-plan design, and how the numbers interact with the rest of your return.

The considerations beyond the payroll-tax math

WHAT THE SALARY COMPARISON LEAVES OUT

The two scenarios isolate the payroll-tax saving because it is the dominant driver. But a complete decision weighs several other factors — some of which can tip a marginal case in either direction.

Retirement plan design

An S-corporation can amplify the value of a solo 401(k) or defined benefit plan, because employer contributions key off W-2 wages. A well-designed plan can change the calculus meaningfully — sometimes enough to justify a structure that the payroll-tax saving alone would not. This interaction is often the strongest reason a physician near the threshold should elect.

California's professional-entity rules

Physicians in California generally cannot operate through an ordinary LLC to deliver medical services; the practice of medicine must run through a professional corporation, subject to the Corporate Practice of Medicine doctrine. The S-election sits on top of that professional-corporation structure. Entity choice and tax election are separate decisions, and the professional-licensing layer has to be right first.

The reasonable-compensation exposure

An aggressive salary is the single most common way an S-corporation invites an IRS adjustment. For physicians — whose market compensation is well-documented and easy to benchmark — the salary must be genuinely defensible. A structure that only works if you underpay yourself is not a structure; it is a deferred assessment.

Administrative cost and discipline

The election commits you to running payroll on a schedule, filing a separate corporate return, maintaining an accountable plan for reimbursements, and keeping cleaner books. For a physician with limited time, the friction is real. The saving has to clear this hurdle, not just exist.

The California 1.5% franchise tax

California does not fully conform to the federal treatment: an S-corporation pays a 1.5% tax on net income (minimum $800). This is a permanent drag that reduces every year's federal saving and must be built into the model — it is a frequent reason a marginal California case comes out differently than it would in a no-income-tax state.

Multi-state and PTET interactions

If you practice across state lines, or if a pass-through entity tax (PTET) election is available, the entity choice ripples into questions of sourcing, apportionment, and state-level deductions that can shift the answer. These are worth modeling before, not after, the election.

How I approach the decision with clients

An S-corporation election is easy to make and genuinely disruptive to unwind. Because of that, I treat it as a modeling exercise, not a rule of thumb. For a physician weighing the question, that means benchmarking a defensible salary to specialty and regional compensation data, projecting the payroll-tax saving against the full cost of the structure, layering in the retirement-plan and PTET interactions, and confirming the professional-entity foundation is sound under California law.

The result is a single, clear recommendation with the numbers behind it — not a default answer applied to every practice. If your independent practice income is approaching or past the level where this question becomes live, it is worth running the actual figures rather than relying on the conventional wisdom that everyone should be an S-corp. For many physicians that wisdom is right; for a meaningful number, it is quietly costing them money.

This article is educational and reflects federal and California rules for the 2026 tax year, including the Social Security wage base of $184,500 and the §199A phase-out thresholds under the One Big Beautiful Bill Act. Reasonable-salary figures used in the scenarios are illustrative and not benchmarks for any specific practice. Tax outcomes depend on individual facts; nothing here is tax advice for your situation. Please consult a qualified CPA before making an entity election.

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