



# Foundational Tax Strategies for Law Firm Owners

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Identify tax strategies to help law firm owners save money



Discuss profile of ideal owner candidate for each strategy



Free up funds to invest in your law firm's growth, or achieve your personal goals



Identify red flags to discuss and be aware of

# Learning Objectives

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# Background

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## Entities

Corporation, LLP, Sole Proprietorship (no LLCs permitted in California for lawyers!)

## Taxation

S-Corporation, C-corporation, Schedule C, Partnership



# Taxation

	Sole Proprietorship	S-Corporation	C-Corporation	Partnership
	Taxed once. Owner is responsible for any taxes due	Taxed once. Owners responsible for any taxes due	Double; both the corporation and the shareholders are taxed	Taxed once. Partners are responsible for any taxes due
Ability to raise capital	Not as separate entity	Yes, but shareholder limits	Yes	Yes
Length of Existence	Until withdrawal or death of owner	Unlimited	Unlimited	Unlimited
Operational Requirements	Relatively few legal requirements	Board of Directors, officers, annual meetings, and annual reporting required	Board of Directors, officers, annual meetings, and annual reporting required	Relatively few legal requirements
Management	Sole Proprietor has full control of management and operations	Managed by directors, who are elected by the shareholders	Managed by directors, who are elected by the shareholders	Typically each partner has an equal voice, unless otherwise arranged
Business Formation	No filing required	State filing required	State filing required	No filing required
Liability	Unlimited liability	Shareholders are typically not personally liable for the debts of the corporation	Shareholders are typically not personally liable for the debts of the corporation	Unlimited liability. A partner can be held liable for the acts of the other partners, increasing personal liability
Limitations on number of owners	Yes	Yes	No	No
Interest Transferability	No unless business is sold to another party	Yes. Some IRS regulations on stock ownership	Shares of stock are easily transferred	No
Limited Personal Liability	No	Yes	Yes	No
Transferability og interest	No	Generally Limited	Yes	No
Dissolution	Easiest	Most complex	Most complex	Easiest



# Retirement

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- 401(k), SEP IRA, Roth 401(k), etc.
- Profit-Sharing Retirement Plan
- Cash Balance Plan
- Defined Benefit Plans
- Tax Deferred vs. Roth





# Convert Schedule C or Partnership to S-Corporation

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Convert sole proprietors, partnerships, & LLC (sometimes) to S-corporations

15% self-employment tax eliminated  
(earnings up to \$128,400, 2.9% on the rest)





# Convert Schedule C or Partnership to S-Corporation

## Example

- Entrepreneurial Emily is married to Edward with two dependent children. She has a law firm she runs as a sole proprietorship. She has gross revenues of \$1,000,000, total costs of \$800,000, and net profits of \$200,000.

## Strategy

- Entrepreneurial Emily sets up an S-corporation to run the business from, and pays herself a \$100,000 salary

## Savings

- Approximately \$11,307 per year





# Schedule C or Partnership to S-Corporation

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## Ideal Candidates

- Schedule C or partnership taxation of business
- Net income of at least \$100,000 (excluding owner compensation)

## Red Flags

- Real estate
- No Bylaws, share certificates, written consents, etc.

## Legal Documents Required

- Entity formation documents, such as Bylaws, written consents/meeting minutes, share certificates, stock ledger, etc.





# Reasonable Compensation for S-Corporation Owners

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- S-corporation owners working in business MUST be paid W2 wage
  - Lower the better, but more audit risk!
- Savings = net income – owner's compensation
  - 15% of amount up to \$128,400
  - 2.9% on amount above \$128,400





# Reasonable Compensation for S-Corporation Owners

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## Example

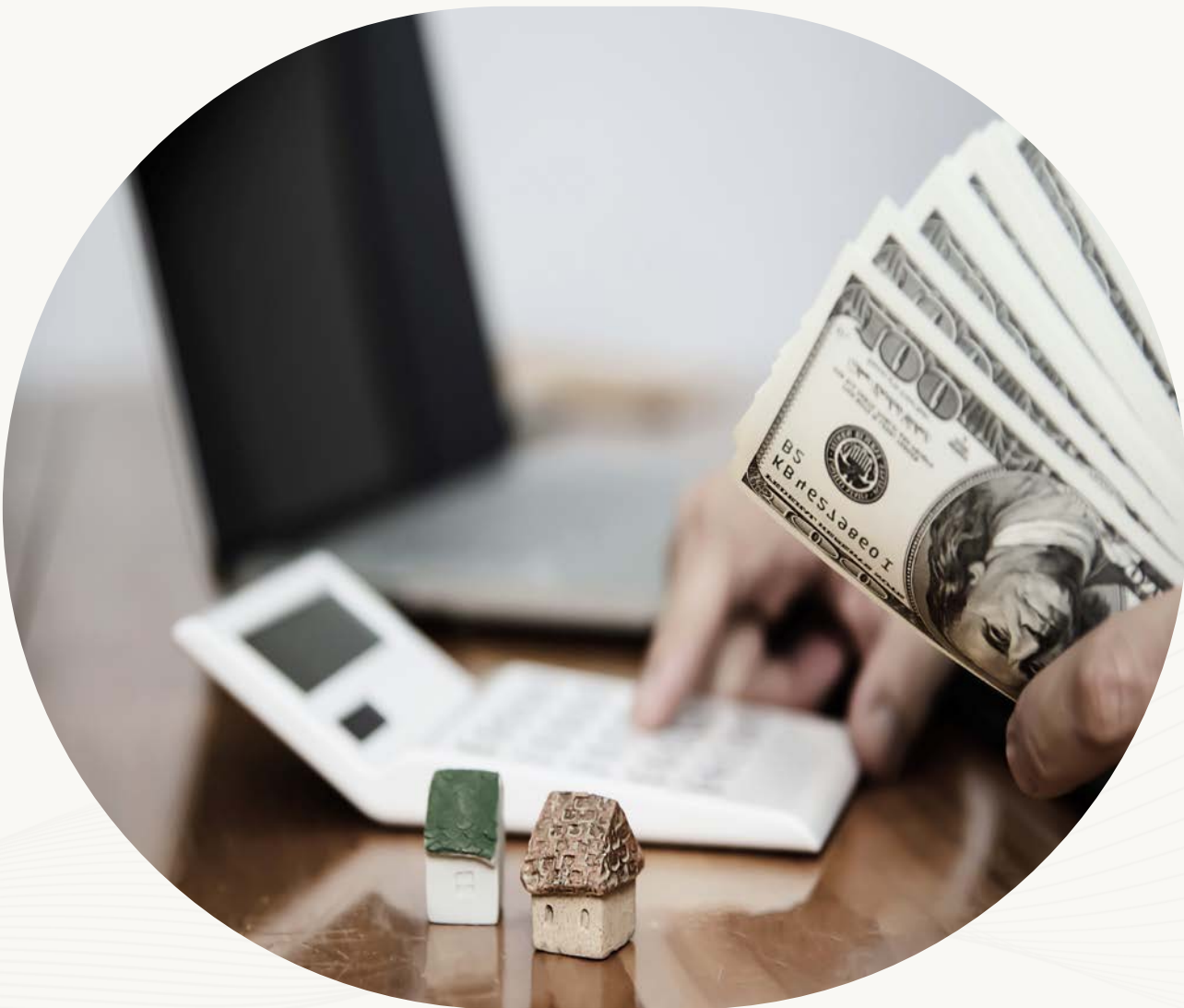
- Entrepreneurial Emily is married to Edward with two dependent children. She has a law firm she runs out of an S-corporation. She has gross revenues of \$1 million, wages to employees of \$335,000, and net profits of \$100,000 after paying herself an annual salary of \$100,000.

## Strategy

- Entrepreneurial Emily runs a reasonable compensation report, stress-tests the report, and reduces her W2 salary to \$90,000

## Savings

- Approximately \$1,382 per year



# Reasonable Compensation for S-Corporation Owners

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## Ideal Candidates

- S-corporation owners with seemingly low (or high) W2 income
- Schedule C or partnership taxation of business

## Red Flags

- C-corporation ownership
- Lack of documentation or rationale for compensation
- No consideration on retirement contributions

## Legal Documents Required

- Written consents/meeting minutes, Reasonable Compensation Report, Stress Test





# Augusta Rule

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- Payments to Board/owners for meetings or events in home (14 days maximum)
- Payments from business are deductible, and payments received by owners are income-tax free







# Augusta Rule

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## Example

- Entrepreneurial Emily operates her law firm out of an S-corporation. She is married to Edward, who also works for the business on a part-time basis. They have a 3,000 square foot home, and often meet in the home to discuss business matters and hold employee appreciation events at the home. Comparable space rental is \$1,200 per meeting.

## Strategy

- S-corporation rents the home from Emily and Edward for business use up to 14 calendar days per year (this is a business deduction and tax-free income to Emily and Edward)

## Savings

- Approximately \$3,266 in annual savings





# Augusta Rule

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## Ideal Candidates

- Corporation with more than one Board Member or owner
- LLP with partnership taxation
- Family businesses (spouse and/or children work in business)

## Red Flags

- Sole proprietorships
- Corporations with one Board Member

## Legal Documents Required

- Written consent/meeting minutes, lease, quotes from vendors





# Home Office Deduction

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## Example

- Entrepreneurial Emily has an office where she conducts the administrative aspects of her law firm. She has a 200 square foot room exclusively and regularly used as her home office. She has many home costs, including Internet, utilities, landscaping, maid services, mortgage interest, security systems, pest control...the list goes on, totaling \$3,500 per month.

## Strategy

- Emily sets up an Accountable Plan and reimburses herself for the proportional amount of indirect costs, as well as mileage traveling to and from her home to her office each day

## Savings

- Approximately \$768 in annual savings





# Home Office Deduction

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## Ideal Candidates

- Business owners who work from home (full or part-time)
- Owners with high costs and expenses related to their home
- Owners with a long commute to office

## Red Flags

- Business owners reporting home office deduction on IRS Form 8829
- No supporting documentation
- Failure to take advantage of ALL deductions

## Legal Documents Required

- Written consent/meeting minutes, Accountable Plan, receipts/invoices







# Hiring Children, Parents, and Grandparents

## Example

- Entrepreneurial Emily and Edward have two children – 14 and 16 years old. Emily needs assistance with mundane task (i.e. scanning, file organization, etc.) for the law firm. They have a strong desire to help them save for college and start building their wealth at a young age.

## Strategy

- Emily and Edward pay each children each \$500 per month for assistance on these tasks through payroll as W2 employees of the business.

## Savings

- Approximately \$1,562 in annual savings
- Social Security & Medicare taxes do not apply for sole proprietorships and partnerships where a spouse is an owner!





# Hiring Children, Parents, and Grandparents

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## Ideal Candidates

- Business owners supporting children or parents
- Business owners who desire to create wealth for children at an early age

## Red Flags

- No supporting documentation substantiating payment amounts (Kiddie Tax!)
- No quotes from vendors for similar services

## Legal Documents Required

- Written consent/meeting minutes, quotes from vendors, employment documents





# Medical Reimbursement Plan

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## Example

- Entrepreneurial Emily and Edward have medical expenses they pay for themselves, as well as their two children, who are growing and have many medical appointments. They can afford the premiums of a high-deductible health plan due to their high income.

## Strategy

- Emily sets up an HSA/HRA and contributes \$8,300 to the account annually, and these funds are invested by their financial advisor

## Savings

- Approximately \$1,594 in annual savings





# Medical Reimbursement Plan

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## Ideal Candidates

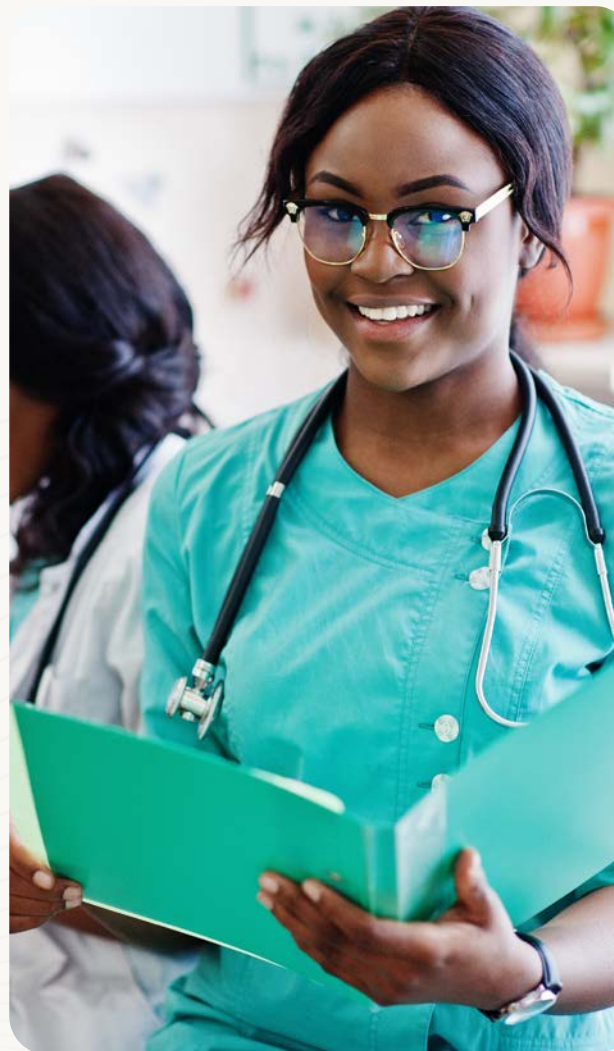
- Business owners with high medical expenses
- Business owners who can afford high-deductible premiums

## Red Flags

- Withdrawing funds from HSA immediately

## Legal Documents Required

- Written consent/meeting minutes authorizing adoption







# Entity Segregation

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- Business with multiple lines sold segregate operations into separate entities
- Savings is (among others) elimination of QBI deduction limit (\$191,950 for single filers and \$383,900 for joint filers in 2024)
  - QBI deduction phased out after 2025!



# Entity Segregation

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## Ideal Candidates

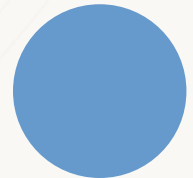
- Businesses that sell multiple goods/services under one entity
- Businesses with net income of more than \$191,950 (single) and \$383,900 (married).

## Red Flags

- Current business structure as S-corporation or C-corporation (depreciation recapture applies)
- No business purpose
- 401(k)/benefits Controlled Groups

## Legal Documents Required

- Entity formation documents for new business (Bylaws, Operating Agreement, etc.)
- Written consent/meeting minutes authorizing act by current business





# Summary

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- Total annual savings = \$18,457
- All strategies MUST be documented (legally) by an attorney
- Basic strategies every law firm owner should be implementing
- What would you do with an extra almost \$20,000 per year?
- How much faster could you reach your financial goals, or grow your law firm, with \$20,000 more to invest *each year*?





# Question?

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- It is important to note that tax laws and regulations may vary by jurisdiction and individual circumstances. Therefore, individuals and organizations are strongly advised to seek personalized legal advice from a qualified tax attorney or legal professional regarding their specific situation.
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