A Guide to Business Owner's Compensation

Owner's Draw

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INTRODUCTION

Business Owner's Compensation

Sole proprietors, partners in a partnership, and the members of a limited liability company (LLC) are not paid wages because they are considered to be self-employed.

How do such individuals take money out of the business? These amounts are commonly referred to as an owner's draw.

What is an Owner's Draw?

Technically, an owner's draw is a distribution from the owner's equity account, an account that represents the owner's investment in the business.

Owner's Dra

Owner's equity is made up of any funds that have been invested in the business, the individual's share of any profit, as well as any deductions that have been made out of the account. That means that an owner can take a draw from the business up to the amount of the owner's investment in the business.

An owner's draw is not a paycheck. Rather, it typically takes the form of a check from the business made out to the sole proprietor or a partner. Note that if the business turns a profit, the owner or partners will be taxed on that amount regardless of whether they took owner's draws that year. Note also that Social Security and Medicare taxes will also be collected from an owner's draw.

* An owner's draw is not a paycheck. Rather, it typically takes the form of a check from the business made out to the sole proprietor or a partner.

Taking Draws as a Sole Proprietor

A sole proprietorship is an unincorporated business entity run and owned by one person with no tax or legal distinctions between the business and its owner.

Unlike an employee, a sole proprietor is not distinct from the business and thus cannot be on the payroll. Instead, sole proprietors take owner's draws from the business entity. How much owners withdraw from the business is up to their discretion, provided that they consider tax rules and cash flow requirements.

How Sole Proprietors Get Paid

A sole proprietor can draw funds from their equity account by writing a check, thus crediting their checking account and debiting their owner's draw account. The transaction only affects their balance sheet, so it is not recorded on the books as an expense.

A sole proprietor pays income taxes based on their net profit. As long as the equity account is greater than zero, they can continue to take draws from the business. However, to stay organized financially, it's preferable for sole proprietors to take regular draws of a fixed amount.

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How an owner's draw might work

$5,000 = **$60,000**

Monthly Profits — Annual Net Income

$40,000 = **$60,000**

Total Annual Draw Taken by Owner — Annual Net Income

Monthly Owner's Draws calculated on Schedule C and included on owner's personal income taxes

Partner Draw

Taking Draws as a Partner

A partnership is two or more people carrying on business as co-owners for profit. Partners cannot be employees of the company, and thus, like sole proprietors, cannot receive a paycheck.

In a partnership, two or more individuals will share the profits and pay income taxes on those profits. A partner's share in a partnership is not necessarily based on the amount each partner has invested in the business, so an owner's share of the business's equity may not be the same as their share of the profits. A partnership agreement is used to specify each partner's share of the profits or losses of the business. Taxes are paid on the partner's share of the profits.

How Partners Get Paid

Each partner may draw funds from the partnership at any time up to the amount of the partner's equity. A partner may also take funds out of a partnership by means of guaranteed payments. These are payments that are similar to a salary that is paid for services to the partnership.

Partners must pay taxes on their partnership income.

Partner equity accounts include:

- → The partner's initial investment in the business
- → Any subsequent investments
- → Earned profits

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* Each partner may draw funds from the partnership at any time up to the amount of the partner's equity.

Taking Draws as an LLC Member

Limited liability companies (LLCs) are businesses separate from their owners, often called members. LLCs offer many of the benefits of a partnership structure without the liability.

LLCs have some of the legal protections of a corporation, but are taxed as either a single-member sole proprietorship or a multi-member partnership.

How LLC Members Get Paid

Similar to sole proprietorships and partnerships, any amounts a member receives from the LLC shall not be taxed as salary or wages. As a result, LLC members receive payments similar to the procedures for owner's draws listed in the sole proprietors or partners section above.

Like those structures, draws by LLC members reduce their equity in the company as members recoup their initial investment.

* LLC members receive payments similar to the procedures for owner's draws listed in the sole proprietors or partners section above.

Justworks Can Help

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