

# Reasonable Compensation for Shareholder-Employees of S Corps

Presented by RCReports, Inc.

*Reasonable Compensation Simplified™*

## Webcast Agenda

- About the Presenters
- Distribution V. Wages
- Reasonable Compensation in the courts
- IRS Guidelines
- Profitability V. Distributions
- IRS hot spot
- Reasonable Compensation Consulting/RCReports Demo
- Conclusion & Takeaways
- Q&A

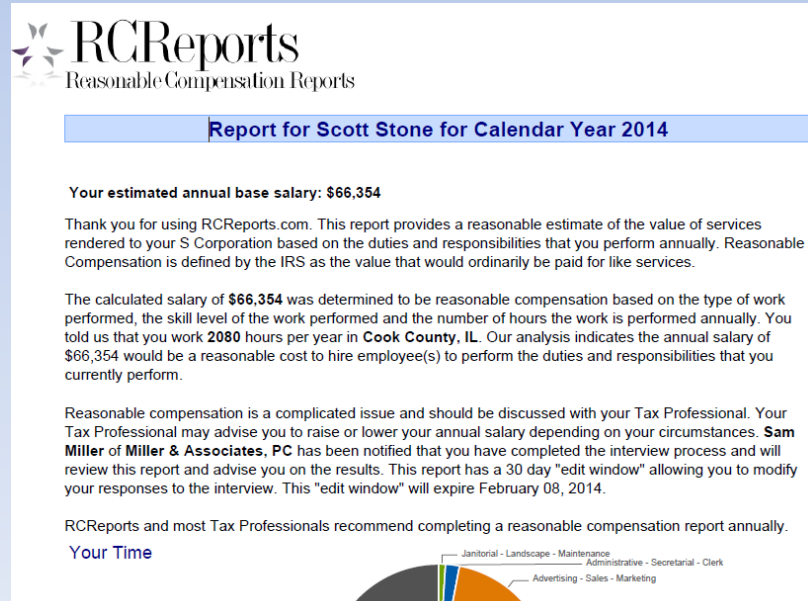
# RCReports, Inc.

- On-line application for determining Reasonable Compensation for Shareholder-Employees of S Corps
  - Tool for CPAs, Tax & Financial Advisors
  - IRS Criteria & Guidelines
  - Court Rulings
  - RCReports exclusive data base of wage
  - Over 800 Occupational Profiles
  - 5,000+ geographic regions in the U.S.

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RCReports  
Reasonable Compensation Reports

**Report for Scott Stone for Calendar Year 2014**

**Your estimated annual base salary: \$66,354**


Thank you for using RCReports.com. This report provides a reasonable estimate of the value of services rendered to your S Corporation based on the duties and responsibilities that you perform annually. Reasonable Compensation is defined by the IRS as the value that would ordinarily be paid for like services.

The calculated salary of **\$66,354** was determined to be reasonable compensation based on the type of work performed, the skill level of the work performed and the number of hours the work is performed annually. You told us that you work **2080** hours per year in **Cook County, IL**. Our analysis indicates the annual salary of \$66,354 would be a reasonable cost to hire employee(s) to perform the duties and responsibilities that you currently perform.





Reasonable compensation is a complicated issue and should be discussed with your Tax Professional. Your Tax Professional may advise you to raise or lower your annual salary depending on your circumstances. **Sam Miller of Miller & Associates, PC** has been notified that you have completed the interview process and will review this report and advise you on the results. This report has a 30 day "edit window" allowing you to modify your responses to the interview. This "edit window" will expire February 08, 2014.

RCReports and most Tax Professionals recommend completing a reasonable compensation report annually.

**Your Time**



## Distribution V. Wages/Salary Terms

- Reasonable Compensation = Replacement Cost  
- Reasonable Compensation = FMV Fair Market Value  
- Distributions = Dividends
- Distributions = Loan repayment, Return of basis
- Shareholder-employee (SE) = Corporate officer
- Shareholder-employee (SE) = S Corp owner

## Distribution V. Wages/Salary

**Wages/Salary = Payroll Taxes**

**Distributions  $\neq$  Payroll Taxes**

Substantial Services = Reasonable Compensation

## Distribution V. Wages/Salary

### Example 1

- Scott Stone 100% of Stone Concrete (S Corp)
- Full Time Employee of Stone Concrete
- \$100,000 income before considering Scott's salary
- Scott takes a \$100,000 salary = taxable income is zero
- \$100,000 wages → 1040

## Distribution V. Wages/Salary

### Example 1 (continued)

- Scott and Stone Concrete responsible for Payroll Taxes
  - 7.65% Stone Concrete SS/Medicare = \$7,650
  - 7.65% Scott Stone SS/Medicare = \$7,650
  - State & Federal Unemployment Tax ???
- Total Tax Liability \$15,300+

## Distribution V. Wages/Salary

### Example 2

- Scott Stone 100% of Stone Concrete (S Corp)
- Full Time Employee of Stone Concrete
- \$100,000 income before considering Scott's salary
- Scott takes a \$100,000 distribution
- \$100,000 income  $\longrightarrow$  1040



## Distribution V. Wages/Salary

### Example 2 (continued)

- Scott and Stone Concrete Payroll Taxes = \$0.00
  - Self Employment Tax = \$0.00
  - Income Tax (return of basis) = \$0.00
  - Total Tax Liability \$0.00
- 
- Net tax savings \$15,300+

## Distribution V. Wages/Salary

**Wages/Salary**



**Distributions**



## Distribution V. Wages/Salary

### IRS REQUIREMENT:

"Distributions and other payments by an S corporation to a corporate officer must be treated as wages to the extent the amounts are reasonable compensation for services rendered to the corporation."

# Reasonable Compensation In the Courts

IRS 25-1\*



**V**



**X**



\*Davis v. U.S.

# Reasonable Compensation In the Courts

DAVID E. WATSON, P.C., V. UNITED STATES OF AMERICA



V



## Reasonable Compensation In the Courts

- Low Salary V. Profit Distributions
  - 2002 Profit = \$203,651
  - 2002 Salary = \$24,000
  
  - 2003 Profit = \$175,470
  - 2003 Salary = \$24,000

## Reasonable Compensation In the Courts

- IRS Objected
  - Education
    - Graduate Degree
  - Experience
    - 20 Years
  - Time
    - Full Time (35-45 hours per week)

# Reasonable Compensation In the Courts

## IRS Audit 2007





## Reasonable Compensation In the Courts

### Reasonable Compensation

\$91,044 for 2002

\$91,044 for 2003

## Reasonable Compensation In the Courts

	2002	2003
Reasonable Compensation	\$91,044	\$91,044
Actual Salary Paid	<u>\$24,000</u>	<u>\$24,000</u>
<u>Re-Characterized</u>	\$67,044	\$67,044

Total Re-Characterization = \$134,088

## Reasonable Compensation In the Courts

**\$48,521**

**\$20,000**

## Reasonable Compensation In the Courts

### Watson V. IRS



# Reasonable Compensation In the Courts

## Ruling in favor of IRS 2010



**V**



## Reasonable Compensation In the Courts

### IRS

- Graduate Degree
- 20 Years experience
- Full Time employee

### Various Job Duties:

- CPA/Accountant
- Partner
- Re-structured businesses for tax purposes

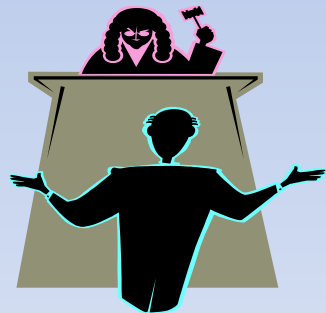
**No Research and No Documentation**

# Reasonable Compensation In the Courts Appealed



# Reasonable Compensation In the Courts

## Upheld District Courts ruling 2012



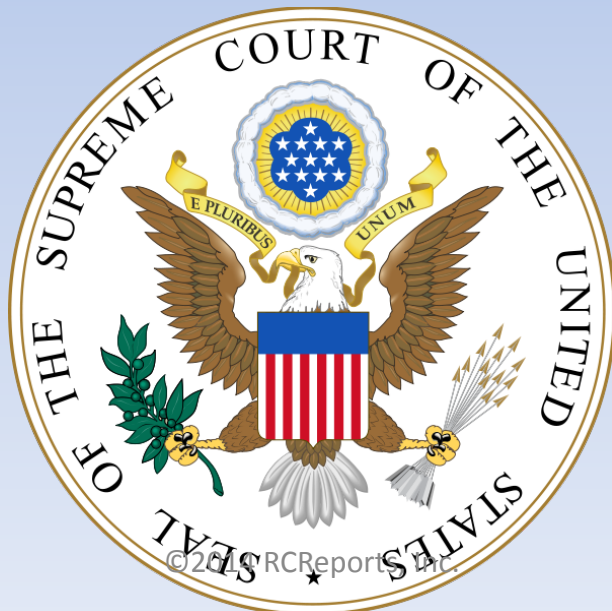
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# Reasonable Compensation In the Courts

## Appeal Denied



# Reasonable Compensation In the Courts

SEAN MCALARY LTD, INC. v. COMMISSIONER (IRS)



**V**



## Reasonable Compensation In the Courts

McAlary Ltd = Real Estate Company

- 2006 Net Income = \$231,454
- 2006 Distribution = \$240,000
- 2006 Salary = Zero

## Reasonable Compensation In the Courts

### IRS Calculation

**\$100,755**

- Primary Job Function – Real Estate Broker
- Full Time (12 hour days 6-7 days per week)
- Compared McAlary LTD performance with peers in the real estate industry 🚫

## Reasonable Compensation In the Courts

### IRS Calculation

**\$100,755**

- **Replacement Cost** – McAlary LTD could expect to pay \$48.44/hour to another individual in exchange for the services Mr. McAlary performed 🚩
- **Fair Market Value** – \$100,755 would be FMV of the services Mr. McAlary performed for his S Corp 🚩

## Reasonable Compensation In the Courts

### IRS Calculation

**\$100,755**

**\$48.44 X 2,080**

- The Bureau of Labor Statistics defines Year-Round, Full-Time employment as **2,080** hours per year.
- 40 Hour Work Week X 52 Weeks/Year
- McAlary often worked 12 hour days with few days off

## Reasonable Compensation In the Courts

### **McAlary Calculation**

**\$24,000**

- Compensation Agreement 🚫
- BOD Meeting Minutes 04-01-2004
- Increases Based on Number of Agents

## Reasonable Compensation In the Courts

### Court Calculation

**\$83,200**

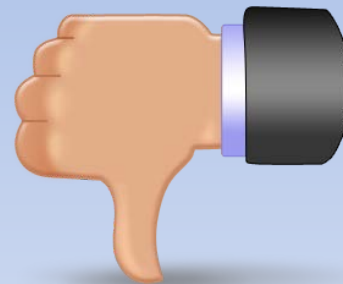
- Various Services 🚫
- Wage Range
- Hourly Wage = \$40.00
- $2,080 \times \$40.00 = \mathbf{\$83,200}$





## Reasonable Compensation In the Courts

### Court Calculation

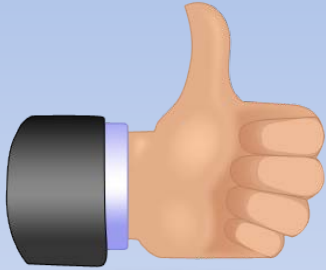
$$2,080 \times \$40.00 = \$83,200$$



**Compensation Agreement** – “We are not persuaded that the remuneration agreement represents a sound measure of the value of the services that Mr. McAlary provided ... The agreement clearly was not the product of an arm's-length negotiation.” 

**Industry Comparison** – “ (IRS Expert) did not explain how a comparison of compensation measured as a percentage of gross receipts with compensation measured as a percentage of net sales would aid the Court ... In the end, we do not find this portion of (the experts) report to be persuasive or helpful.  ©2014 RCReports, Inc.

## Reasonable Compensation In the Courts



### Court Calculation

$$2,080 \times \$40.00 = \$83,200$$

- **Various Services** – Management; Supervision; Recruiting; Sales; Advertising; Purchasing; Bookkeeper; Record Keeping... 🚫
- **Experience** – Low; New to the Industry
- **COESS-BLS** – Range \$32.99 to \$64.28

**“Determining an employee's reasonable compensation is dependent upon a number of factors and is far from an exact science.”**

# Reasonable Compensation In the Courts

## Court Rulings

- Sean McAlary Ltd, Inc. v. Commissioner 2013
- Glass Blocks Unlimited v. Commissioner 2013
- Patrick & Suzanne Herbert v. Commissioner 2012
- David E. Watson, P.C. v. United States 2010
- JD & Associates, LTD v. United States 2006
- Joseph M. Grey Public Accountant, P.C. v. Commissioner 2002
- Veterinary Surgical Consultants,P.C. v. Commissioner 2001
- Joly v. Commissioner 2000
- Spicer Accounting, Inc. v. United States 1990
- Joseph Radtke, S.C. v. United States,1989
- .....

# IRS Guidelines

IRS Definition of Reasonable Compensation:

“Reasonable compensation is the value that would ordinarily be paid for like services by like enterprises under like circumstances”

IRS Code 162(a)(1):

“Reasonable & Services Rendered”

- Replacement Cost
- Fair Market Value

## IRS Guidelines

### Notice of Acceptance as an S Corporation

We would also like to take this opportunity to inform you of your tax obligations related to the payment of compensation to shareholder-employees of S corporations.

When a shareholder-employee of an S Corporation provides services to the S corporation, reasonable compensation generally needs to be paid. This compensation is subject to employment taxes.


Tax practitioners and subchapter S shareholders need to be aware that Revenue Ruling 74-44 states that the Internal Revenue Service (IRS) will re-characterize small business corporation dividends paid to shareholders as salary when such dividends are paid to the shareholders in lieu of reasonable compensation for services.

This position has been supported in several recent court decisions.



## Distribution V. Wages/Salary

**Some factors considered by the courts in determining reasonable compensation:**

- Training and experience
- Duties and responsibilities
- Time and effort devoted to the business
- Dividend history
- Payments to non-shareholder employees
- Timing and manner of paying bonuses to key people
- What comparable businesses pay for similar services
- Compensation agreements 
- The use of a formula to determine compensation

## IRS Guidelines

The key to establishing reasonable compensation is determining what the shareholder-employee did for the S corporation

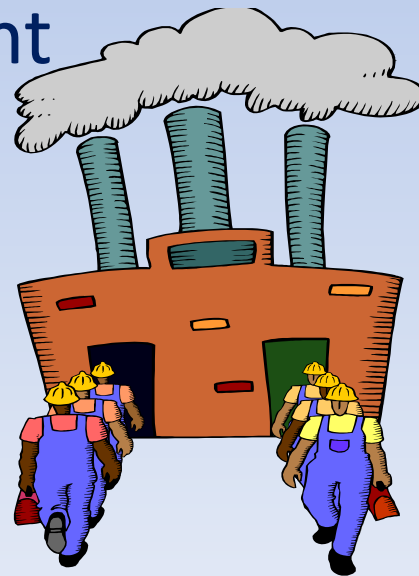
1. Services of non-shareholder employees
2. Capital and equipment
3. Services of shareholders





## IRS Guidelines

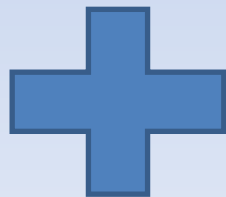
Services of non-shareholder employees, or  
Capital and equipment



## IRS Guidelines

### Services of shareholder

In addition to the shareholder-employee direct generation of gross receipts, the shareholder-employee should also be compensated for administrative work performed !



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# IRS Guidelines

## Services of shareholder

Factors in determining reasonable compensation:

**1. Training and experience**



**&**

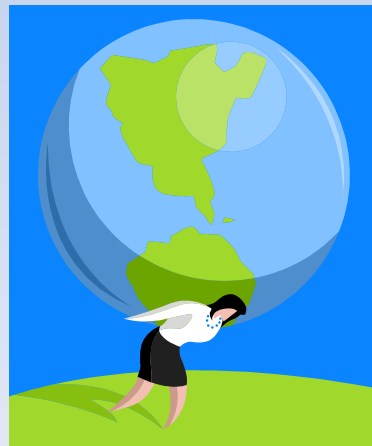


# IRS Guidelines

## Services of shareholder

Factors in determining reasonable compensation:

### 2. Duties and responsibilities



# IRS Guidelines

## Services of shareholder

Factors in determining reasonable compensation:

### 3. Time and effort devoted to the business



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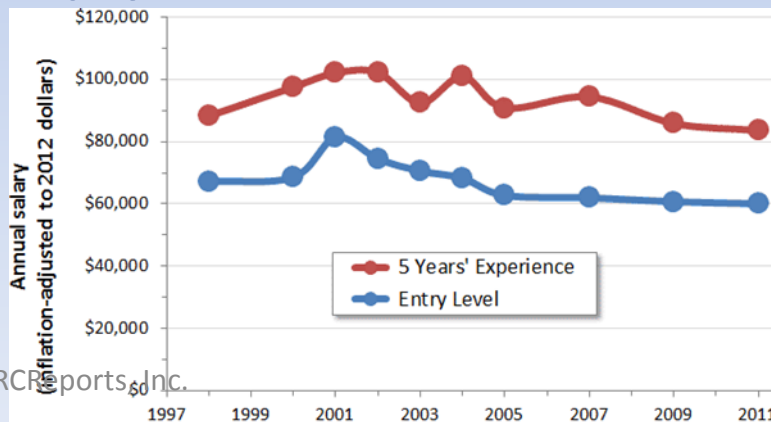


# IRS Guidelines

## Services of shareholder

Factors in determining reasonable compensation:

### 4. What comparable businesses pay for similar services

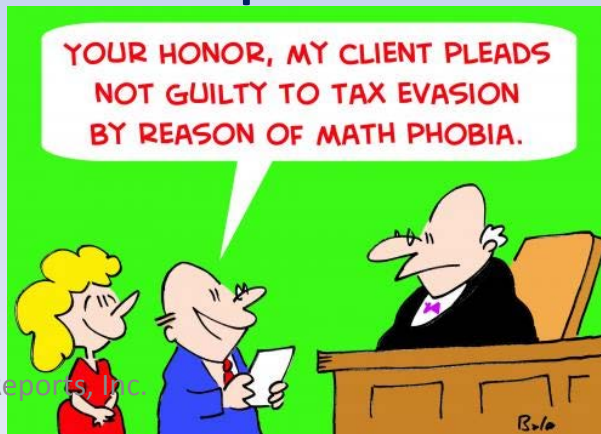
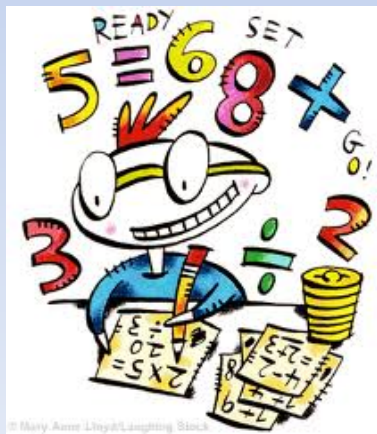


# IRS Guidelines

## Services of shareholder

Factors in determining reasonable compensation:

### 5. The use of a formula to determine compensation



# IRS Guidelines

## Services of shareholder

Factors in determining reasonable compensation:

### 6. Payments to non-shareholder employees





# IRS Guidelines

## Services of shareholder

Factors in determining reasonable compensation:

### 7. Compensation agreements



# IRS Guidelines

## Services of shareholder

Factors in determining reasonable compensation:

- 8. Timing and manner of paying bonuses to key people**

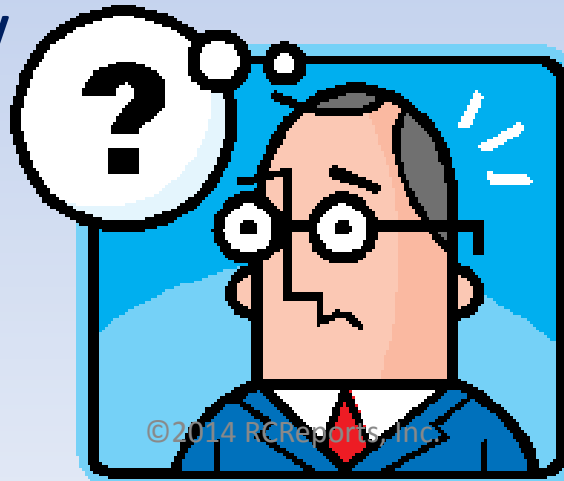


# IRS Guidelines

## Services of shareholder

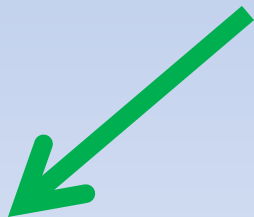
Factors in determining reasonable compensation:

**9. Dividend history**

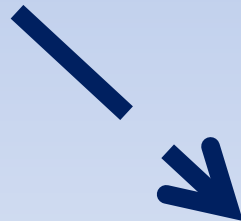


# Profitability V. Distributions

Reasonable Compensation



**Distributions**



**Profitability**

“The amount of reasonable compensation will never exceed the amount received by the shareholder either directly or indirectly.”

# Profitability V. Distributions

## Example 1

- Scott Stone 100% of Stone Concrete (S Corp)
- Scott's RC figure = \$74,685
- 2011 Stone Concrete Net Profit = \$190,000
- Scott takes \$160,000 out of Stone Concrete
- Scott receives wages (RC) of \$74,685
- Scott receives a distribution of \$85,315  
\$160,000

# Profitability V. Distributions

## Example 2

- Scott Stone 100% of Stone Concrete (S Corp)
- Scott's RC figure = \$74,685
- 2012 Stone Concrete Net Profit = \$23,000
- Scott takes \$30,000 out of Stone Concrete
- Scott receives wages (RC) of  $\$30,000$
- Scott receives a distribution of  $\underline{\$0}$   
 $\underline{\underline{\$30,000}}$

# Profitability V. Distributions

## Example 3

- Scott Stone 100% of Stone Concrete (S Corp)
- Scott's RC figure = \$74,685
- 2012 Stone Concrete Net Profit = \$150,000
- Scott takes \$0 out of Stone Concrete
- Scott receives wages (RC) of \$ 0.00
- Scott receives a distribution of \$ 0.00  
\$ 0.00

# Profitability V. Distributions

## Example 4

	2010	2011	2012	Total
Scott RC	\$75k	\$75k	\$75k	\$225k
Net Profit	\$130k	\$135k	\$145k	\$410k
Scott Takes	\$0	\$0	<b>\$400k</b>	
Wages	\$0	\$0	<b>\$225k</b>	
Distribution	\$0	\$0	\$175k	



## Shareholder Loan or Capital Contribution

GLASS BLOCKS UNLIMITED v. COMMISSIONER (IRS)



**V**



How an S Corp can Lose Money and Still be  
Required to Pay Reasonable Compensation

## Shareholder Loan or Capital Contribution

### Glass Blocks Unlimited – Fredrick Blodgett

- 2007 Net Income = \$877
- 2007 Transferred in = \$45,000
- 2007 Transferred out = \$30,844
- 2007 Salary = Zero

## Shareholder Loan or Capital Contribution

### IRS Position

- Transfer in was a contribution to capital (basis)
- Transfer out was a distribution (Return of basis)
- Reasonable Compensation must be paid before a distribution can be made

## Shareholder Loan or Capital Contribution

### Glass Blocks Position

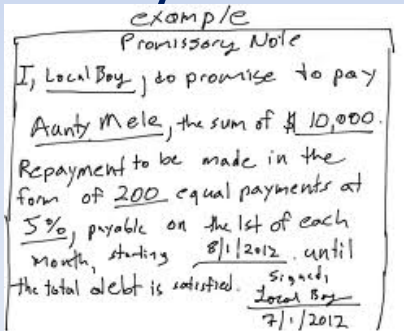
- Transfer in was a shareholder loan to GBU
- Transfer out was a repayment of the shareholder loan
- Reasonable Compensation does not apply

## Shareholder Loan or Capital Contribution

### Court Finding

Transfers in question were capital contributions and not bona fide loans

- No Written Agreements or Promissory notes
- No interest charged
- No security (collateral)
- No fixed repayment schedule



*example*  
Promissory Note  
I, Local Boy, do promise to pay  
Aunty Mele, the sum of \$ 10,000.  
Repayment to be made in the  
form of 200 equal payments at  
5%, payable on the 1st of each  
month, starting 8/1/2012, until  
the total debt is satisfied. Signed  
Local Boy  
7/1/2012

## Shareholder Loan or Capital Contribution

### Court Finding

*“Where the expectation of repayment depends solely on the success of the borrower's business, rather than on an unconditional obligation to repay, the transaction has the appearance of a capital contribution.”*

## Shareholder Loan or Capital Contribution

### Math

– Net Income (before)	\$877
– Employment Taxes	<u>\$-2,360</u>
– Penalty & Interest	<u>\$-1,923</u>
– 2007 Net Loss (after)	<u><u>\$-3,406</u></u>

# Substantial Services

DAVIS v. UNITED STATES (1994)



V





## Substantial Services

### DAVIS v. UNITED STATES

Mile High Calcium Owned by:

- Carol L. Davis
- Henry Adams (husband)
- Transfers In and Out
- Assessment \$39,220

## Substantial Services

### DAVIS v. UNITED STATES

Henry Adams – President (Officer)

- No Active Participation
- Worked for outside employers
- There is an exception for officers who perform only minor services... (Treas. Reg. § 31.3121(d)-(1)(b))

## Substantial Services

### DAVIS v. UNITED STATES

Carol L. Davis

- 12 hours per week
- Services worth \$8.00 hour
- FICA & FUTA \$647.32

## Reasonable Compensation - IRS Hot Spot

Prior to 2005 the most recent compliance study of S corporations involved about 10,000 returns from tax year 1984



# Reasonable Compensation - IRS Hot Spot

TIGTA 7-2002:

## The IRS does not always address S Corp officer compensation during examination

- Reviewed 84 S Corp returns that had been audited: The average wages were \$5,300 and the average distribution was \$349,323 **(PROBLEM)**
- It is critical for the examiner to determine the level of service provided by the SE before an allocation of officer compensation can be made **(TRAINING)**
- Recommend that the Director of Compliance for SB/SE division provide technical guidance and resources (such as software) to field personnel to aid in determining reasonable officer compensation **(TOOLS)**

# Reasonable Compensation - IRS Hot Spot

**IRS July 2005:**

## **IRS Launches Study of S Corporation Reporting Compliance**

TIGTA August 2006:

**Filing Characteristics and Examination Results for Partnerships and S Corporations**

TIGTA January 2007:

**The National Research Program Study of S Corporations Has Been Effectively Implemented, but Unnecessary Information Was Requested From Taxpayers**

TIGTA April 2008:

**Additional Actions Are Needed to Effectively Address the Tax Gap**

TIGTA April 2008:

**Trends in Compliance Activities Through Fiscal Year 2007**

TIGTA June 2009:

**Trends in Compliance Activities Through Fiscal Year 2008**

TIGTA July 2011:

**Trends in Compliance Activities Through Fiscal Year 2010**

# Reasonable Compensation - IRS Hot Spot

GAO December 2009

## Actions Needed to Address Noncompliance with S Corporation Tax Rules

- 68 percent of S corporation returns filed for tax years 2003 and 2004 misreported at least one item affecting net income
- For those years, the overall net misreported amount that S corporations passed through to individual shareholders was about \$85 billion
- JCT & TIGTA reports show that inadequate shareholder wage compensation is a **SIGNIFICANT** issue

# Reasonable Compensation - IRS Hot Spot

**GAO December 2009**

## **Actions Needed to Address Noncompliance with S Corporation Tax Rules**

- S corporations failed to pay adequate wages to shareholders for their labor for the corporation
- GAO calculated that in the 2003 and 2004 tax years, the net shareholder compensation underreporting equaled roughly \$23.6 billion



# Reasonable Compensation - IRS Hot Spot

Noncompliance was the highest in not paying the correct wage compensation to S corporation shareholders

**Table 2: Most Common Misreported Line Items by Number of S Corporations Misreporting and Amounts Misreported (Absolute Dollar Values), Tax Years 2003 and 2004 Combined**

Misreported line items	Number misreported (in thousands)	Net misreported amount (in billions)	Median misreported amount
Net income <sup>a</sup>	4,542	\$84.8 <sup>c</sup>	\$5,459 <sup>d</sup>
Other deductions <sup>b</sup>	3,532	37.2 <sup>c</sup>	4,204 <sup>d</sup>
Distributions <sup>e</sup>	1,852	61.8 <sup>h</sup>	7,411 <sup>f</sup>
Gross receipts or sales	1,508	25.8 <sup>h</sup>	3,988 <sup>g</sup>
Cost of goods sold	1,311	— <sup>e</sup>	3,003 <sup>g</sup>
Depreciation expense	1,000 <sup>c</sup>	5.7 <sup>h</sup>	1,755 <sup>i</sup>
Shareholder compensation	887 <sup>c</sup>	23.6 <sup>g</sup>	20,127 <sup>g</sup>
Purchases	801 <sup>c</sup>	— <sup>e</sup>	2,031 <sup>h</sup>
Taxes and license expense	651 <sup>c</sup>	1.4 <sup>g</sup>	271 <sup>h</sup>
Repairs and maintenance expense	585 <sup>c</sup>	2.8 <sup>g</sup>	1,505 <sup>g</sup>
Interest expense	574 <sup>c</sup>	2.3 <sup>g</sup>	985 <sup>h</sup>

# Reasonable Compensation - IRS Hot Spot

**GAO December 2009**

## **Actions Needed to Address Noncompliance with S Corporation Tax Rules**

- When examiners used BLS statistics as their benchmarking tool, they adjusted shareholder compensation 66% of the time.
- Implementing such a tool could improve the effectiveness of IRS examinations of shareholder compensation
- The adjustment amount when using BLS data averaged \$30,000. 50% more than the median of \$20,000

# Reasonable Compensation - IRS Hot Spot

**GAO December 2009**

## **Actions Needed to Address Noncompliance with S Corporation Tax Rules**

### Recommendations:

- Further analyze the extent of noncompliance involving a long standing concern over inadequate shareholder compensation, and identify options for improving compliance **(PROBLEM)**
- Improve guidance to IRS examiners so that they might better target and determine adequate shareholder compensation **(TRAINING & TOOLS)**

# Reasonable Compensation - IRS Hot Spot

TIGTA June 2012

## **The Recommended Adjustments From S Corporation Audits Are Substantial, but the Number of No-Change Audits Is a Concern**

- In FYs 2007 through 2011, SB/SE Division examiners completed 53,544 audits of S corporation returns
- Recommended \$5.7 billion in adjustments
- For each return audited in FYs 2007 through 2011, examiners generated about \$105,534 in recommended adjustments

# Reasonable Compensation - IRS Hot Spot

TIGTA June 2012

## The Recommended Adjustments From S Corporation Audits Are Substantial, but the Number of No-Change Audits Is a Concern

The large number of recommended adjustments, combined with two other factors, will likely **lead to an increase in the number of S Corp audits.** 

1. Growing number of S Corps
  - A. 1997 to 2011 S Corp returns increased from 2.5 million to 4.5 million an 80% increase
  - B. 5.7 million S Corp returns by 2015 an increase of 26% over 2011
2. Compliance risk they pose (Reasonable Compensation)
  - A. 94% of S Corps are held by 3 or fewer shareholders

# Reasonable Compensation - IRS Hot Spot

TIGTA June 2012

**The Recommended Adjustments From S Corporation Audits Are Substantial, but the Number of No-Change Audits Is a Concern**

## **Recommendations:**

- The Director, Research, SB/SE Division, should analyze S corporation data files to develop audit leads to help select additional productive returns for audit
- Improve guidance to IRS examiners so that they might better target and determine adequate shareholder compensation **(TRAINING & TOOLS)**

# RCReports

## Adding Reasonable Compensation Planning

1. **S Corp**
2. **Entity Planning**
3. **Valuation**
4. **Other Issues**



# RCReports

## Reasonable Compensation Reports



### Report for Scott Stone for Calendar Year 2014

Your estimated annual base salary: **\$66,354**

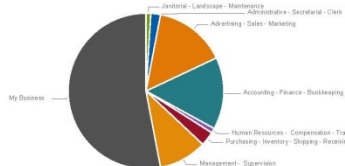
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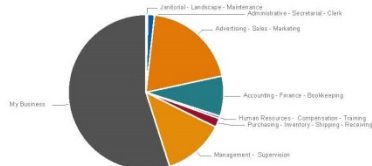
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Your Time



Your Salary



Annual Salary and Reasonable Compensation are used interchangeably in this report. All salary and reasonable compensation figures are expressed annually and in U.S. dollars. Reasonable Compensation Reports by RCReports.com - <http://www.rcreports.com>



### Report for Scott Stone for Calendar Year 2014

Janitorial - Landscape - Maintenance				1% of your time	21 hours/year	0.37% of comp.
Task	Proficiency	Category	Overall	Hours	Wage	Annual
Janitors and Custodians	Average	100%	1%	20.8	\$ 11.90	\$ 248

Administrative - Secretarial - Clerk				2% of your time	42 hours/year	1.38% of comp.
Task	Proficiency	Category	Overall	Hours	Wage	Annual
Customer Service Representatives	High	100%	2%	41.6	\$ 22.04	\$ 917

Advertising - Sales - Marketing				15% of your time	312 hours/year	19.87% of comp.
Task	Proficiency	Category	Overall	Hours	Wage	Annual
Sales Representatives	High	100%	15%	312.0	\$ 42.25	\$ 13,182

Accounting - Finance - Bookkeeping				15% of your time	312 hours/year	8.34% of comp.
Task	Proficiency	Category	Overall	Hours	Wage	Annual
Bookkeeper	Average	33%	4.95%	103.0	\$ 18.52	\$ 1,908
Billing and Invoice Clerks	Average	62%	9.3%	193.4	\$ 17.02	\$ 3,292
Collections Clerk	High	5%	0.75%	15.6	\$ 21.66	\$ 338

Human Resources - Compensation - Training				1% of your time	21 hours/year	0.52% of comp.
Task	Proficiency	Category	Overall	Hours	Wage	Annual
Human Resources Clerk	Low	100%	1%	20.8	\$ 16.45	\$ 342

Purchasing - Inventory - Shipping - Receiving				3% of your time	62 hours/year	1.88% of comp.
Task	Proficiency	Category	Overall	Hours	Wage	Annual

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### Report for Scott Stone for Calendar Year 2014

Purchasing - Inventory - Shipping - Receiving				3% of your time	62 hours/year	1.88% of comp.
Purchasing Clerk	Average	100%	3%	62.4	\$ 19.96	\$ 1,246

Management - Supervision				10% of your time	208 hours/year	12.72% of comp.
Task	Proficiency	Category	Overall	Hours	Wage	Annual
General and Operations Managers	Average	49%	4.9%	101.9	\$ 47.93	\$ 4,884
Supervisor of Administrative and Clerical Workers	High	51%	5.1%	106.1	\$ 33.51	\$ 3,555

My Business				53% of your time	1,102 hours/year	54.92% of comp.
Task	Proficiency	Category	Overall	Hours	Wage	Annual
Concrete Finishers	High	46%	24.38%	507.1	\$ 37.13	\$ 18,829
Maintenance Workers, Machinery	High	54%	28.62%	595.3	\$ 29.59	\$ 17,615

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## Steps to reach a replacement cost of FMV figure

1. Make a complete list of all the services you provide to your S Corp
2. Apportion your time among all the services listed
3. Rate your level of expertise and experience for each service performed
4. Gather wage data on all the services listed and at the appropriate level of expertise
5. Assemble all your research and data and calculate your Reasonable Compensation figure

# Conclusions

## COMPENSATION PAID TO SHAREHOLDERS WHO PERFORM SERVICES



## Conclusions

**Underpayment of salaries results in the large underpayment of FICA taxes, and encourages the IRS to proactively pursue the issue**



# Conclusions

Distributions to a shareholder who performs services to their S Corp will be re-characterized as wages if the distributions are actually disguised compensation

UNREAL CORPORATION		Check #	12345
Payroll Account		Date:	July 31, 20XX
Pay to the order of	<u>I. M. Fictitious</u>	\$	<u>1,834.00</u>
*****One-Thousand, Eight-Hundred, Thirty-Four and no/100 Dollars*****			
<b>NOT a REAL Bank</b>			
Memo	<u>July payroll for Fictitious</u>	<u>Certainly Void</u>	
<i>Detach below before depositing, and save for your records:</i>			
Employee:	I. M.	Gross Earnings	\$3,000.00
Pay Period:	July 20XX	Deductions:	
		Federal Income Tax	\$349.00
		State Income Tax	117.00
		Social Security	180.00
		Medicare/Medicaid	45.00
		Insurance	175.00
		Retirement Savings Plan	200.00
		Charity	25.00
		Health/Child Care Flex Plan	75.00
			1,166.00
		<b>Net Pay</b>	<b>\$1,834.00</b>

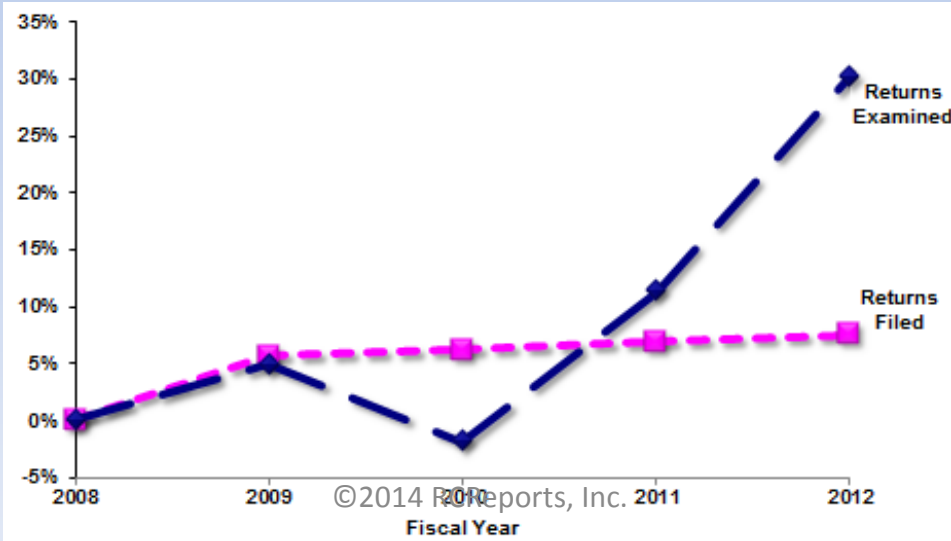


# Conclusions

**S Corp audits were on the Rise**



**TIGTA August 2013**



# Conclusions

## S Corp audits Declined in 2013



## TIGTA September 2014



## Conclusions

# No Safe Harbor for Reasonable Compensation



## Conclusions

**Reasonable Compensation – Subjective**

**“Determining an employee's reasonable compensation is dependent upon a number of factors and is far from an exact science.”**



## Conclusions

Who should Research and Document their Reasonable Compensation Figure

Any Shareholder-Employee of an S Corp who performs services for their company



# Conclusions

## How to support your Reasonable Compensation Figure

- Develop a consistent year to year Reasonable Compensation policy
- Determine your Reasonable Compensation figure using the IRS guidelines and the 9 factors handed down by the courts
- Add your Reasonable Compensation documentation, reasoning, and notes to your corporate minutes

## Conclusions

Compensation must be both REASONABLE & SUPPORTABLE with clear DOCUMENTATION outlining how the compensation figure was reached

### Report for Scott Stone for Calendar Year 2014

Your estimated annual base salary: **\$66,354**

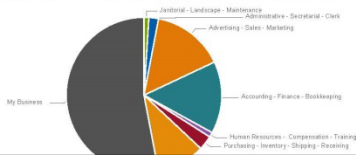
Thank you for using RCReports.com. This report provides a reasonable estimate of the value of services rendered to your S Corporation based on the duties and responsibilities that you perform annually. Reasonable Compensation is defined by the IRS as the value that would ordinarily be paid for like services.

The calculated salary of **\$66,354** was determined to be reasonable compensation based on the type of work performed, the skill level of the work performed and the number of hours the work is performed annually. You told us that you work **2080** hours per year in Cook County, IL. Our analysis indicates the annual salary of **\$66,354** would be a reasonable cost to hire employee(s) to perform the duties and responsibilities that you currently perform.

Reasonable compensation is a complicated issue and should be discussed with your Tax Professional. Your Tax Professional may advise you to raise or lower your annual salary depending on your circumstances. **Sam Miller of Miller & Associates, PC** has been notified that you have completed the interview process and will review this report and advise you on the results. This report has a 30 day "edit window" allowing you to modify your responses to the interview. This "edit window" will expire February 08, 2014.

RCReports and most Tax Professionals recommend completing a reasonable compensation report annually.

Your Time



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# Reasonable Compensation for Shareholder-Employees of S Corps

Presented by RCReports, Inc.

*Reasonable Compensation Simplified™*

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