# Reasonable Salary Recap

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Keeping your salary low is what drives the savings in an S corporation. Recall that $10,000 in salary costs you about $1,530 in payroll taxes. However, through the IRS Fact Sheet and several **Tax Court cases**, the assignment of reasonable shareholder salary becomes qualitative in relation to several factors such as your role and qualifications, and the relationship to net income and distributions (just to name a few).

Labor data such as **Risk Management Association** (RMA) and Bureau of Labor Statistics (BLS) including RCReports can be hit or miss. Homogenized populations cannot definitely tell the IRS or the Tax Court what you should be paid. It could be a tool in your toolbox, or it could be one of the many nails in your coffin.

Don’t forget the **assembled workforce effect** and return on investment arguments.

Also recall that self-employed health insurance and Health Savings Accounts (HSA) add to your Box 1 wages on your W-2. Let’s say your reasonable salary is $60,000 and you pay $12,000 in health insurance premiums. You would pay yourself a $48,000 salary but your W-2 Box 1 and Line 7 (Officer Compensation) on your S corporation tax return would show $60,000, but only $48,000 is subjected to Social Security and Medicare taxes.

One of the best ways to win an argument is to not have the conversation in the first place. The IRS is focused on S corporations who do not pay any salary, or who pay a ridiculously low salary. For them, it is an easy analysis. Line 7 versus Line 21 of the S Corp tax return (Form 1120S). They can also look at the K-1, Box 1 (ordinary income) and compare this to Box 16, Code D (distributions). There’s probably an app for that.

IRS scrutiny will only increase over time, but they also want winnable cases. The low hanging fruit is the S Corp without any reasonable shareholder salary. Why go after someone who is paying themselves $50,000 in salary just to settle on $60,000 after negotiation? An extra $1,530 in the IRS pocket for arguably a tough audit might not be worth it to them. This scenario is contrasted to the person who pays themselves $10,000 and it should be $60,000. There’s some cash in that IRS challenge!

There is a calculated risk when determining reasonable compensation for S corporations. You can eliminate the risk by paying yourself 100% of the net business income but then again that completely defeats the purpose of an S Corp. You can pay yourself 0% and wait for the audit. Or… ideally… you can operate in the soft middle.

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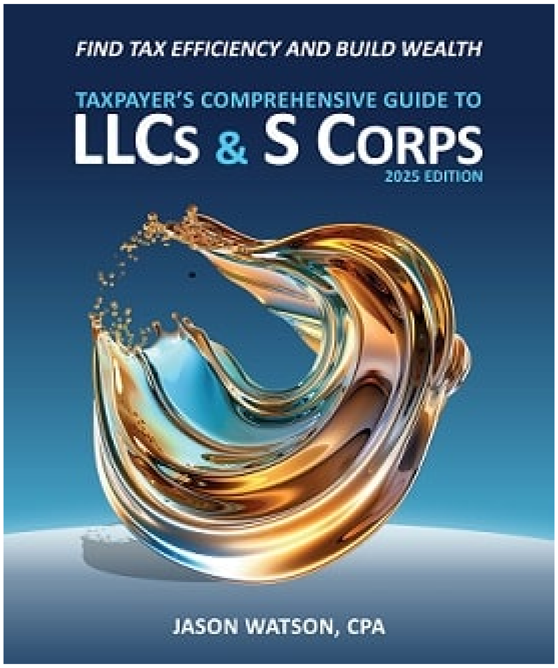


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