

Everything You Know about Reasonable Compensation is **WRONG**

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Nice to meet you!

- Expert on determining Reasonable Compensation for closely-held business owners
- Educated + 100,000 financial professionals on reasonable compensation and has been published in numerous national and state journals



Reasonable Compensation Myths



1
Calculating
Reasonable
Compensation

2
QBI
Deduction

3
Entity
Selection

Calculating Reasonable Compensation



60/40 Rule

Industry Rule

Wild A** Guess

50/50 Rule

Safe Harbor Rule



Myth:

60/40 Rule or 50/50 Rule

"The 60/40 rule is a simple approach that helps S corporation owners determine a reasonable salary for themselves. Using this formula, they divide their business income into two parts, with 60% designated as salary and 40% paid as shareholder distributions."



Myth:

Industry Rule

Set wages as a percentage of sales or revenue based on industry standards | Payroll as a percentage of Net-Income

"That reasonable salary can be anywhere from 30-50% of the net income from your business."



edwardcollins_upleveled
Edward Collins · 2023-9-6

Myth:

Safe Harbor Rule

Set wages at the Social Security maximum limit

Myth:

Wild A** Guess

"Save employment taxes by setting up your consulting business as an S-Corp. At the lower end you get to decide a fair wage to pay yourself and save social security taxes."



markjkohler
Mark J. Kohler · 2023-11-11

What is the risk of getting this wrong?



IRS Audit risk for client



Back penalties & interest on reclassified wages



Preparer penalties from the IRS

How to Determine Reasonable Compensation

The Cost Approach

Many Hats Approach

The Market Approach

Industry Comparison Approach

The Income Approach

Independent Investors Approach

+ Documentation!

How – Cost Approach

- All Tasks Performed
- Apportion Time
- Skill-Proficiency
- Comparability Data
- Small Business



"The consultant said I was wearing too many hats."



Sample Cost Report

Reasonable Comp Figure

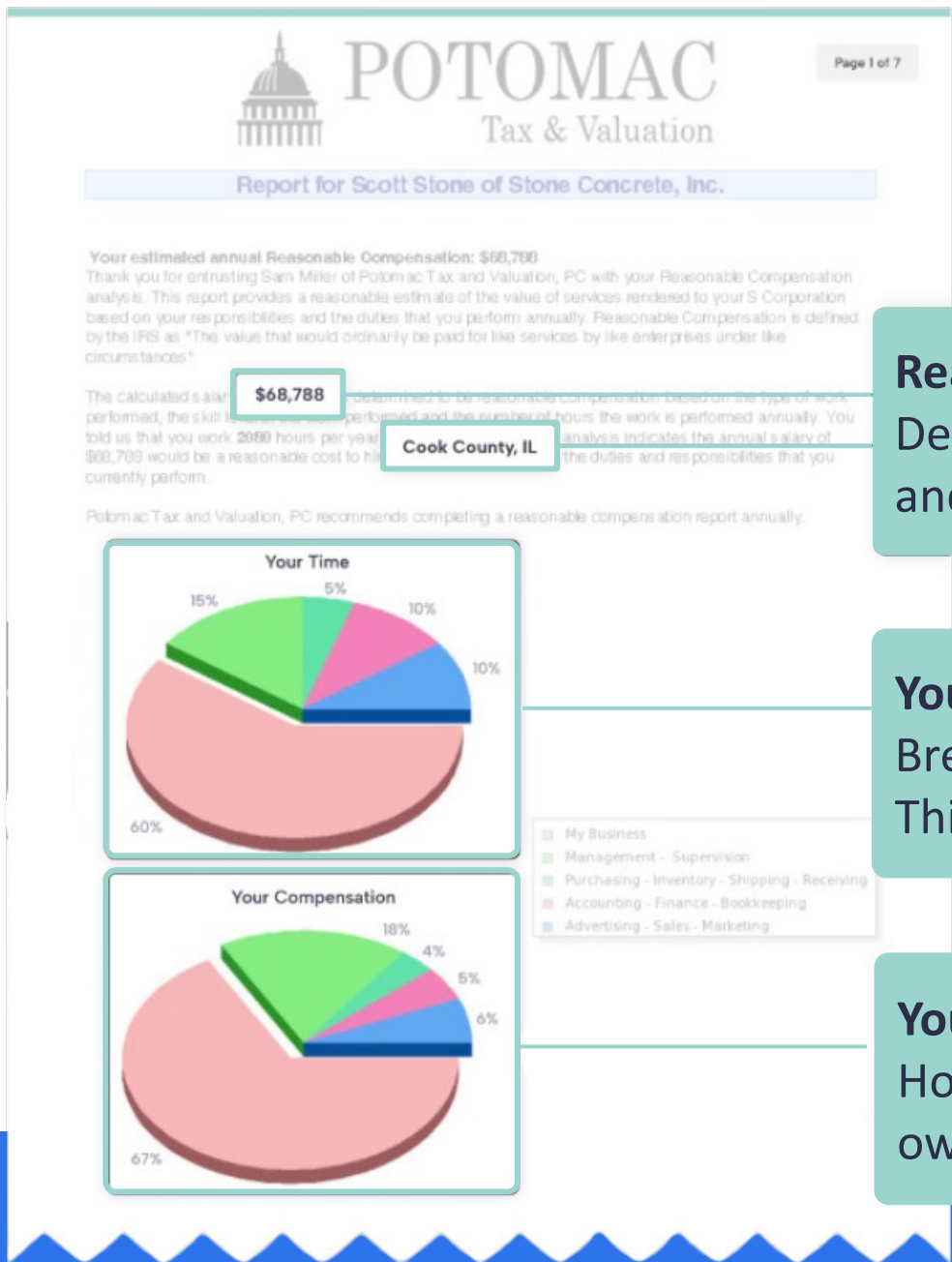
Details the salary range for the owner’s industry and location and provides a suggested reasonable compensation figure.

Your Time

Breakdown of how the owner spends their time in the business. This information is based on the interview completed.

Your Compensation

How the compensation number is affected by each task the owner performs.



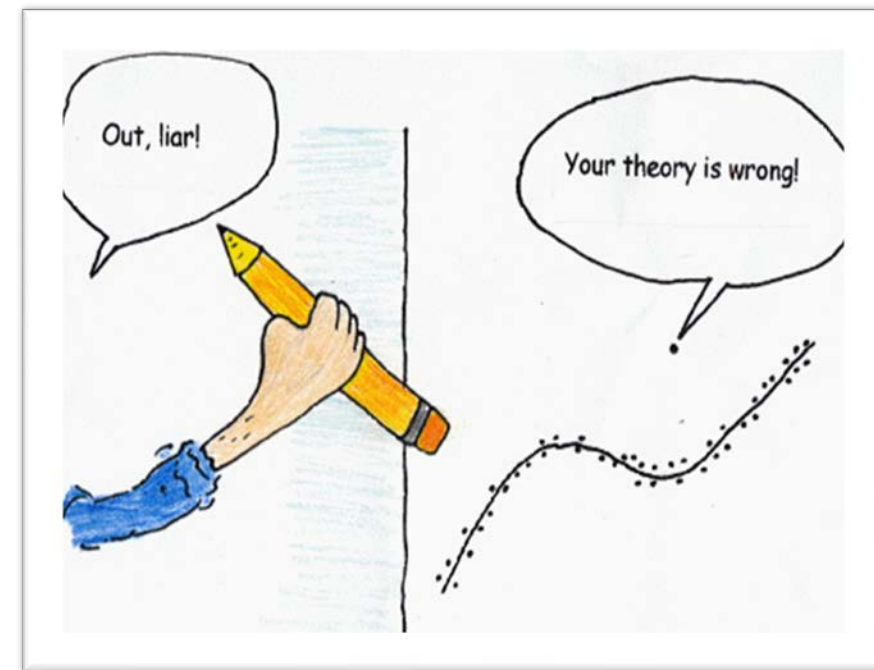
How – Market Approach

- Best used when you have someone who is truly performing CEO duties
- Size
- Industry
- Management
- Comparability Data
- Medium Business

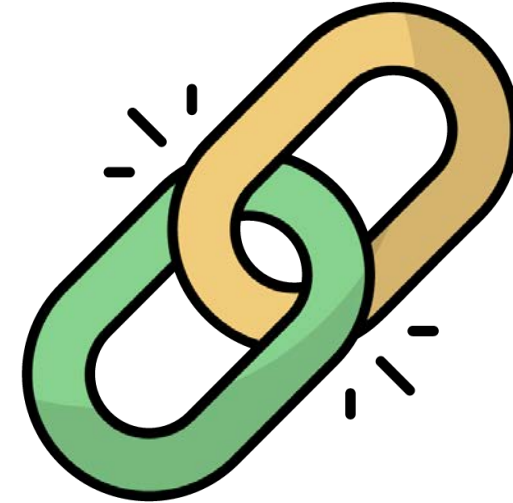


How – Income Approach

- Best used when there is absolutely no comparability data for the client (this is very rare)
- No Comparable Wage Data
- ROI v. Reasonable Compensation
- Outliers
- 2nd Opinion/Test



Thank you!



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