



**GreerWalker**  
CPAs & Advisors



# Determining Reasonable Compensation for S-Corp Owners



**As an owner of an S-Corp, understanding the concept of reasonable compensation is crucial for tax planning and compliance. Navigating the complexities of the tax system can be challenging, but being aware of the rules and regulations can help you maximize tax savings while staying within the guidelines set by the Internal Revenue Service.**

As an owner of an S-Corp, understanding the concept of reasonable compensation is crucial for tax planning and compliance. Navigating the complexities of the tax system can be challenging, but being aware of the rules and regulations can help you maximize tax savings while staying within the guidelines set by the Internal Revenue Service.

An S-Corp is a unique business structure that offers significant tax advantages. It is similar to a C-Corp in that it provides limited liability protection to its owners but differs in how it is taxed. S-Corps do not pay corporate income tax. Instead, the company's income, losses, and deductions are passed through to the shareholders, who report them on their personal income tax returns.

One of the main advantages of an S-Corp is the opportunity to minimize self-employment taxes. Pass-through income from an S-Corp to the owner is not subject to these taxes. Thus, this structure can potentially save an S-Corp owner significant tax dollars.

However, this tax advantage brings a key requirement. S-Corp owners who provide services to their company are required by the IRS to receive "reasonable compensation" in the form of salary or wages. The IRS stipulates that an S-Corp owner who performs more than minor services for the corporation and receives, or is entitled to receive, compensation must be treated as an employee.

Employee wages are subject to payroll taxes. Therefore, an owner-employee is incentivized to minimize their wages, which are subject to payroll taxes, and maximize their pass-through income, which is not.





An additional incentive is the Qualified Business Income deduction. The Tax Cuts and Jobs Act introduced a 20% deduction on qualified business income from an S-Corp. However, the wages paid to S-Corp owners reduce the qualified business income passed through to the owner since the S-Corp deducts the wages as a business expense. Therefore, owners are incentivized to minimize their wages to maximize the qualified business income, which in turn maximizes the 20% deduction.

The term “reasonable compensation” is somewhat ambiguous, as the IRS does not provide a specific formula to calculate it. The IRS generally defines reasonable compensation as the amount that would ordinarily be paid for similar services by similar businesses under similar circumstances. Factors that may be considered in determining reasonable compensation include the owner’s roles and responsibilities, time and effort devoted to the business, training and experience, and what other businesses pay for similar services.

The IRS has a history of scrutinizing S-Corps to ensure that reasonable compensation is being paid, especially if there’s no record of compensation paid to owner-employees. Failure to pay reasonable compensation can lead to the recharacterization of distributions as wages, resulting in back taxes and penalties.

While deciding how much to pay yourself as an S-Corp owner, you should consider your business’s unique circumstances and industry standards. You can leverage industry statistics, employer-review sites, and professional services that specialize in reasonable compensation analysis to help determine a fair salary. It’s vital to document your decision-making process when setting your compensation and keep all supporting documentation.



# Final Thoughts

The purpose of this document is to provide a brief overview of taking reasonable compensation from an S-Corp and is not a substitute for speaking with one of our expert advisors. If you would like to discuss your unique situation and learn more about maximizing your tax savings while staying within IRS guidelines, please contact our office.

We're always happy to help.



# About GreerWalker

GreerWalker LLP is a CPA firm providing tax, assurance, accounting, and advisory services focused on the needs of privately held middle market companies, owners and individuals. From our offices in North and South Carolina, we provide specialized expertise across a varied spectrum of industries and market segments for a regional, national and international clientele.

Through our investment banking affiliate, GreerWalker Corporate Finance LLC, we also offer exit planning and merger and acquisition services as well as customized wealth planning via our affiliate GreerWalker Wealth Management LLC.



GreerWalker  
Charlotte Office:  
227 W. Trade St., Suite 1100  
Charlotte, NC 28202

Greenville Office:  
15 South Main St., Suite 800  
Greenville, SC 29601



NC - (704) 377-0239  
SC - (864) 752-0080



[greerwalker@greerwalker.com](mailto:greerwalker@greerwalker.com)



[www.greerwalker.com](http://www.greerwalker.com)

