



In this episode Eric & Melissa discuss the often misunderstood – REASONABLE COMPENSATION.

So what the heck is “Reasonable Compensation” when you own a business?

According to the IRS website (see post [HERE](#)) “S corporations **must** pay reasonable compensation to a shareholder-employee in return for services”

It’s vague, and for those of us rule followers that’s....annoying!

But despite a desire for a set in stone answer (which we absolutely do not want) the IRS is simply stating that one of the requirements of a S-Corp is that owners must be paid ‘Reasonable Compensation’ for their work and efforts.

There are of course a variety of reasons why we don’t want to IRS to give us a set number – but I get it – the rule is so incredibly vague....

Here are some helpful tips for determining Reasonable Compensation when it comes to S-Corp owners;

What can the business afford?

A new corporation will most likely not have the cash flow to support a single or several large salaries.

What is industry standard for the position or duties performed?

Depending upon the job title or titles (yes in the beginning we all wear a LOT of hats) a quick internet search with the job title and salary will produce a good starting point on what you should be paying yourself.

A simple Google search for ‘project manager salary’ yielded the following results;

project manager salary

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Salary Estimates

Source	Salary Range	Job Title	Location
Indeed	\$74k–150k per year	Project Manager	Sacramento, CA
ZipRecruiter	\$65k–160k per year	Project Manager	Sacramento, CA
Glassdoor	\$92k–160k per year	Project Manager	Sacramento, CA

Is there data to support your numbers?

Again a small amount of research for applicable job title, duties & description will give you an idea of 'Reasonable Compensation' for the position that is the best fit for the job duties you are performing.

Remember it can be adjusted. The salary that you elect to pay yourself based upon your S-Corps cash flow may need to be adjusted throughout the year based upon what your company can afford. This is fine and easy to do with most payroll companies.

The IRS does not want you paying yourself on payroll to avoid payroll taxes to yourself or anyone else and just take a distribution that's taxed at a lower rate. Not paying yourself reasonable compensation with a profitable business can get you into some trouble. Documentation is important in situations where it may look as if you made a large profit but actually you didn't. Understand that when you become a corporation either a S or C Corp you should be held to a higher standard.

No matter what point you are at in your business, you should be paying yourself something. A mistake that many business owners make is to feel that the company's money is yours to spend immediately. That money has to be accounted for and be moved from being the company's money to being your money. You can do this by paying yourself a wage or taking a distribution on top of a wages.

Where do I start? When you are newer to owning and operating a business as well as not having much historical data it may be difficult to know where to start. In the beginning, **25%** of your deposits is a good start and once you have more data to work from then you can talk to your professionals about a better plan.

When looking into reasonable compensation for yourself, you want to research your profession and look at the range of fair market value in your business profession. You do not want to pay yourself lower than what your profession typically makes just to avoid payroll taxes.

Remember Poor bookkeeping = increased tax liability.

Need help getting a handle on your books. Check out Melissa's newest book ***The 4-Hour Bookkeeper*** available at INeedBookkeeping.com or Amazon.com

Eric & Melissa Broughton are Co-Owners of Busy Bee Advisors a Northern California Based Tax and Accounting Firm specializing in helping their client to pay their fair share in taxes. They are also hosts of the popular podcast **The Real Buzz: Taking the sting out of Taxes** (available to download on all major podcast platforms). Melissa is proud to be the author of ***Busy Bee Advisors Guide to Basic Bookkeeping*** and ***The 4-Hour Bookkeeper*** both titles are available at INeedBookkeeping.com

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