

# ClientLine®

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## REASONABLE COMPENSATION FOR S CORPORATION OWNERS

Choosing an S Corporation (S Corp) as the best legal structure for your business provides tax perks, but it also comes with limits: paying owners a reasonable salary.

### SELF-EMPLOYED OR EMPLOYEE

All self-employed people are business owners. But not all business owners are self-employed. The owner of an S Corp isn't considered self-employed in the eyes of the IRS, unlike sole proprietors or partners in a partnership. Instead, they're considered both an employee

(if they work in the business) and a company shareholder. This distinction is critical because owners of S Corps don't pay self-employment tax on their share of the company's profits.

of payments should be classified as wages since the shareholder did the work.

### WHAT'S REASONABLE?

Although there's no clear definition of what's reasonable compensation, there are a few factors to consider, such as:

- ❖ Training and experience
- ❖ Duties and responsibilities
- ❖ Time and effort devoted to the business
- ❖ Competitive costs for similar services
- ❖ Payments to non-shareholder employees



### GET TO WORK

To prevent owners from taking all business income as a distribution of profit and avoid paying any self-employment tax, the IRS requires that owners who provide services to the S Corp collect a reasonable salary.

### SALARY OR PROFITS

Determining whether a shareholder payment is a paycheck or profit distribution, first look at how much of the company's sales revenue was generated by the shareholder's personal services. If the company has no other employees or subcontractors, then a reasonable amount

### IT'S TAXING

Payments to S Corp owners for services rendered are treated no differently than the salary you would pay an employee. Payroll taxes including FICA and federal and state income tax must be withheld from the paycheck, and the company must pay FUTA and state unemployment taxes. Form W-2 will be provided to the owner in January, as with all employees.

S Corporations are complex compared with other business structures, so if you're considering S Corp tax status for your business, consult with your tax professional.

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## New RMD Tables for 2022

The IRS released new life expectancy tables to be used for calculating required minimum distributions (RMDs) from IRAs and qualified plans like 401(k)s. The new tables, which were last updated in 2002, reflect longer life expectancies and allow account holders to spread RMDs over a longer period, potentially lessening annual tax burdens and easing account depletion concerns. The new tables go into effect on January 1, 2022.

Let's look at an example that demonstrates the difference in withdrawal amounts. In 2022, a 72-year-old IRA owner will use a 27.4-year life expectancy compared to 25.6 years under the old tables. If the IRA balance on January 1, 2022 is \$1 million, the required minimum distribution will be approximately \$36,500, compared to \$39,100 in 2021.

Keep in mind that non-eligible designated beneficiaries are still subject to the 10-year rule that requires all funds to be withdrawn by the end of the tenth year following the account holder's death.



## NEW YEAR, FRESH START

If the pandemic has caused a slowdown in reaching your financial goals, now is the time to review your plans and push reset for 2022. Your financial and tax professionals can guide you through this process.

### REVISIT YOUR GOALS

No doubt that the last couple of years have caused many of us to shift priorities. Start with reviewing your previous goals and see if they've changed. Perhaps the ultra-competitive real estate market has put your home buying plans on the back burner. Identify what's important to you this year and a few years down the road.

### PUT IT IN WRITING

After a year of living one day at a time, you may now have some breathing room to look forward. Put those new short-term and long-term goals in writing. Having a written financial plan will help you focus while helping to keep you on track and moving forward.

### EXPECT THE UNEXPECTED

The pandemic has taught us to expect the unexpected. Layoffs, stay-at-home orders, and remote work have taught us to be adaptable. It also raised awareness about the need to look at financial preparedness for emergencies and

unknowns. For example, you may need to replenish your emergency fund to eventually cover three to six months of expenses. Also, review your insurance coverage to help avoid a financial catastrophe.

### CANCEL SUBSCRIPTIONS

As you get back to socializing with friends and family, you may be spending less time at home. So, you may not need that many streaming subscriptions and memberships that you used during lockdowns. Cancel anything that you find yourself rarely using anymore and reallocate those funds to your emergency fund or savings goals.

### ONLINE VIGILANCE

Keep your eyes out for cybercriminals looking for an easy payday. Be skeptical about unsolicited messages and online shopping offers that seem too good. With the numerous federal and state assistance programs created during the pandemic, scammers are looking for ways to get their hands in your pocket.

## Client PROFILE...

Elena's consulting business is expanding and now has clients in Germany and Mexico. How can she reduce the amount of foreign currency exchange fees she'll incur when clients pay in their local currency?

While international expansion is exciting, it adds a layer of complexity to your business. Elena should first consider having her customers pay in U.S. dollars, instead of euros or pesos. This will shift the foreign currency exchange risk to her client, eliminate any exchange fees she may incur and simplify her business recordkeeping.

But if getting paid in dollars isn't an option, Elena should open business bank accounts in multiple currencies. Her German client can pay in euros that get deposited into Elena's euro

bank account. And if Elena has the chance to pay business expenses in euros, for example, when traveling or making online purchases, she can use this bank account to access her funds.

If Elena needs to convert her euros to dollars, she'll pay her bank's exchange fee and exchange rate. But there are online international banking options with costs that are less expensive than legacy banks.

*Client Profile is based on a hypothetical situation.*

*The solutions we discuss may or may not be appropriate for you.*

# KEEP BENEFICIARY DESIGNATIONS CURRENT

When was the last time you reviewed beneficiary information on your life insurance policies, retirement accounts and will? It's important to check all accounts because in many cases, beneficiary designations on policies and retirement plans supersede what is written in your will or trust documents.

## DESIGNATE A PRIMARY

A primary beneficiary is the one who will inherit your asset. Keep in mind that your state may restrict who you can appoint. For example, your spouse may need to sign a waiver before you can select someone else as the primary beneficiary.



beneficiary is next in line if that person dies before you. Most accounts don't require one, but it's a good idea to name a secondary to ensure your assets are distributed how you want.

## COMPLETE THE PROCESS

It's a good idea to review everything at the same time. Make sure your will or trusts include all your assets, your insurance

## CHOOSE A BACKUP

While the primary beneficiary is first in line to receive your asset, the secondary or contingent

coverage is adequate and that you are on track with retirement savings. Meet with your financial and legal professionals annually.

# MARKETING ON A BUDGET

Small businesses often operate on tight budgets. But fortunately, there are ways you can market your business without spending a lot.

## EXPAND AND ASK

Ask for referrals from current customers. You can ask them verbally as a project is wrapping up or through email or social media if your business is cloud-based.

## GIVE IT AWAY

Hosting a free workshop, webinar or event that highlights your product or service is a great way to get in front of your ideal customer. People love learning, so classes can be a great way to build meaningful connections.



## BE CHARITABLE

Consider sponsoring a local event. Backing your favorite charity is rewarding and your business gets publicity. As a bonus, your business may be able to take a tax deduction for your sponsorship expenses.

## BE SOCIAL

Use your social media channels to run a contest or giveaway. You may have to spend a little for a prize or offer your product or service at no charge, but the number of participants and new potential leads you get will be worth the price.

# ... Q&A

## Q Are there tax credits available for my small delivery business if I purchase electric vehicles?

A A tax credit of up to \$7,500 per vehicle is available when you purchase an electric car from a manufacturer that has sold less than 200,000 electric automobiles. Tesla and General Motors have already crossed that threshold, so a tax credit is not available for their vehicles. Additional requirements for the tax credit are that the car must be purchased new from the manufacturer, and you must use it primarily in the United States.

## Q The Social Security Number on my W-2 is incorrect. What should I do?

A January is the time of year when informational tax forms like W-2s, 1099s and 1098s begin appearing in mailboxes. Be sure to check them carefully for accuracy. And if you discover a mistake, contact the sender immediately. They'll need to issue a corrected form. If it's an incorrect W-2, your employer will send you a W-2c. And for 1099s and 1098s, they'll check the box next to the word *corrected* at the top of the form. Always use information from the updated document on your tax return because the IRS will flag anything that doesn't match, potentially creating delays or creating an unexpected tax bill.



# ClientLine® SHORT BITS...

## > 2022 OUTLOOK

According to a recent survey completed by The Harris Poll, 71% of small and medium-sized businesses say they survived the pandemic through digitization. And 79% say that these changes will help them to be prepared for future adversity. Just over half expect to maintain a remote work environment utilizing their new technologies.

## > INTERNATIONAL TRAVEL

Pew Research Center completed a recent survey and found that most Americans (71%) have traveled internationally at some point in their lives. Approximately 19% have visited one foreign country while

only 11% have been to more than ten countries. College graduates are more likely to have traveled to multiple countries. At least a quarter of college graduates have been to at least ten different countries.

## > SOCIAL SECURITY

In 2020, nearly 70 million Americans collected benefits from the Social Security Administration, with approximately 71% receiving payments because of retirement and 13% due to disability. Of the 70 million beneficiaries, 5.8 million were new recipients in 2020 who collected an average of \$1,636 per month in retirement benefits. For 2020, the Social Security trust

fund collected \$1.1 trillion in revenue, with nearly 90% coming from payroll tax contributions.

## > EDUCATION PLANS

At the end of December 2020, approximately \$425 billion was invested in Section 529 plans designed to help save for education expenses. Many of those funds were in savings accounts, with only approximately \$27 billion held in prepaid tuition plans. According to the Investment Company Institute, the total \$425 billion represents a 14.5% increase over December 2019. The number of accounts increased 4% to 14.8 million in 2020 over 2019.

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