

## THIS MONTH:

- ◆ Don't Overanalyze and Miss an Opportunity
- ◆ Determining Reasonable Compensation
- ◆ Husband and Wife Businesses
- ◆ Effective Rent vs. Stated Rent

### Don't Overanalyze and Miss an Opportunity



Overanalyzing a situation can be as bad as not giving it enough thought. Most decisions are made on some sort of deadline. Even very smart individuals examine the data to the point that coming to a conclusion is put off for too long. It is easy to continue to research in order to make sure a decision is absolutely correct.

Sometimes, the best course of action may be to just make a decision based on the information you have and hope for the best. You may not always be right, but delaying some decisions could result in lost opportunities. Don't get caught over thinking a decision when swift action is what is needed.

### Determining Reasonable Compensation

The IRS has the authority to reclassify dividends, distributions, or payments to the shareholder-employee as compensation if it deems compensation inadequate or unreasonable. The courts have held that the question of reasonable compensation is one of fact, determined on a case-by-case basis. The IRS lists the following factors in determining reasonable compensation: training and experience, duties and responsibilities, time and effort devoted to the business, dividend history, payments to non-shareholder employees, timing and manner of paying bonuses to key people, what comparable businesses pay for similar services, compensation agreements, and the use of a formula to determine compensation. Sources of information on comparable compensation for services include the U.S. Department of Labor's Bureau of Labor Statistics, employment agencies, and a market analysis. The key in defending a claimed compensation amount is to document all research to support the amount of salary. To discuss reasonable salary in more detail, please contact your Padgett office today.



## Husband and Wife Businesses

One of the advantages of operating your own business is hiring family members. However, the employment tax requirements for family employees may vary from those that apply to other employees.

### How spouses earn Social Security benefits

A spouse is considered an employee if there is an employer/employee type of relationship, i.e., the first spouse substantially controls the business in terms of management decisions and the second spouse is under the direction and control of the first spouse. If such a relationship exists, then the second spouse is an employee subject to income tax and FICA (Social Security and Medicare) withholding. However, if the second spouse has an equal say in the affairs of the business, provides substantially equal services to the business, and contributes capital to the business, then a partnership type of relationship exists and the business's income should be reported on Form 1065, *U.S. Return of Partnership Income*

### Both spouses carrying on the business

Generally a qualified joint venture whose only members are a husband and wife filing a joint return are not treated as a partnership for Federal tax purposes. A qualified joint venture

is a joint venture involving the conduct of a trade or business, if (1) the only members of the joint venture are a husband and wife, (2) both spouses materially participate in the trade or business, and (3) both spouses elect to have the provision apply. Under the provision, all items of income, gain, loss, deduction and credit are divided between the spouses in accordance with their respective interests in the venture. Each spouse takes into account his or her respective share of these items as a sole proprietor, each filing a Schedule C. For purposes of determining net earnings from self-employment, each spouse's share of income or loss from a qualified joint venture is reported on Form SE. This generally does not increase the total tax on the return, but it does give each spouse credit for social security earnings on which retirement benefits are based.

### One spouse employed by another

If your spouse is your employee, not your partner, you must pay Social Security and Medicare taxes for him or her. The wages for the services of an individual who works for his or her spouse in a trade or business are subject to income tax withholding and Social Security and Medicare taxes, but not to FUTA tax.

## Effective Rent vs. Stated Rent

When comparing the rental rates for different properties for your business, it is important to think about the expenses involved. For example; who is responsible for utilities, real estate taxes and maintenance? As an enticement to sign a lease, you could negotiate free rent or the landlord might allow you a reduction if you agree to pay for alterations to the space. Consider these complexities before you sign a lease. Free rent or other expenditures may be spread over the term of the lease to allow you to properly allocate monthly costs. Comparing different leases, or options in the same lease, can add up to significant savings. Understand effective rent vs. stated rent with help from your accountant.

### PADGETT BUSINESS SERVICES®

WHERE YOUR SUCCESS TAKES ROOT<sup>SM</sup>

PADGETT BUSINESS SERVICES® is dedicated to meeting the tax, government compliance, profit & financial reporting and payroll needs of businesses with fewer than 20 employees in the retail and service sector of the economy. This publication suggests general business planning concepts that may be appropriate in certain situations. It is designed to provide complete and accurate information to the reader. However, because of the complexities of the tax law and the necessity of determining whether the material discussed herein is appropriate to your business, it is important you seek advice from your Padgett office before implementing any of the concepts suggested in this newsletter.

**PENALTY NOTICE:** As required by U.S. Treasury regulations, you are advised that any written tax advice contained herein was not written or intended to be used (and cannot be used) by any taxpayer for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code.

