

CURCHIN NAVIGATOR

SUMMER 2011



Current Issues Regarding Reasonable Compensation

By Kimberly C. Melski, CPA, PSA



If the IRS was challenging a company in regards to reasonable compensation, would you think that an executive's compensation was deemed too high or too low? If you answered both you would be correct.

The Internal Revenue Code allows corporations a deduction for reasonable salaries or other compensation paid to its employees. The Code is subjective in nature and has led to the IRS challenging or disputing what is deemed reasonable compensation paid to officers/executives.

In recent years, the IRS has been more focused on this area as it pertains to closely held corporations. Corporations that are closely held have officers/executives who are usually the owners of the corporation. Unlike publicly traded corporations who have compensation committees made up of independent Board of Director members, a closely held corporation has its compensation determined by the officers/executives. In other words, officers/executives of closely held corporations decide what they consider reasonable to pay themselves.

The factors listed in the IRS Audit Manual used in determining if the compensation is reasonable include the following:

1. Nature of the employee's duties
2. Employee's background and experience
3. Employee's knowledge of the business
4. Size of the business
5. Employee's contribution to the profit making of the business
6. Time the employee dedicates to the business

7. Economic conditions, in general and locally
8. Character and amount of responsibility of the employee
9. Time of year compensation is determined
10. Relationship of officer/executive's compensation to stockholdings
11. Whether the claimed compensation is in reality, in whole or in part, true compensation or payment for a business or assets acquired
12. Amount paid by similar businesses in the same area to equally qualified employees for similar services

The IRS determines reasonable compensation differently for C Corporations and for S Corporations. They use the same guidelines to determine if the compensation is reasonable, but for a C Corporation they look to see if the compensation is too high, where for an S Corporation they look to see if the compensation is too low.

In a C Corporation, if the compensation is determined to be too high, the IRS could reclassify the "excess" wages to dividends and penalize the company accordingly. This would lead to the double taxation of the excess wages - taxation at both the corporate level and the personal level.

For example, at year end, a company has a \$500,000 profit. In order to reduce the corporate tax, the officer/executive declares that a bonus of \$500,000 be paid to him/herself. If he/she performs the same duties as another employee and the other employee does not benefit from the bonus, the IRS could see this as inequitable and reclassify the \$500,000 as a dividend.

This causes the \$500,000 to be double taxed. The dividend increases the taxable profit of the corporation, as a dividend is non-deductible, and also taxes the officer/executive personally on the dividend income.

In the case of an S Corporation, the IRS would look at the wages to see if they are too low. They would also look to see if the officer/executive was receiving a distribution in addition to the reduced wages and could determine that the company was attempting to avoid paying payroll taxes on the monies earned.

For example, an officer/executive receives an annual salary that is well below that of an employee performing the same duties. At year end, there is a taxable profit. Instead of the officer/executive paying the profit out in the form of payroll and paying employment taxes on those funds, he/she pays the money out in the form of a distribution which is not subject to these taxes. If that was the IRS determination, they would assess social security (if the wages already reported are not over the social security limit) and medicare taxes on these monies. The rates used would be equal to the total rate charged on wages, meaning both the employer's and the employee's portions. In 2011, these rates are 10.4% for social security and 2.9% for medicare.

If you feel that your company may have a reasonable compensation issue or wish to discuss this further, please feel free to contact our office.

New Jersey – Business Loss Carryovers Beginning in 2012

By Peter Pfister, CPA



Beginning with the 2012 tax year, New Jersey individual taxpayers will be permitted to net gains and losses derived from the following business categories of gross income: net profits from business (sole proprietorships); net gains or net income from rents, royalties, patents, and copyrights; partnership income; and net pro rata share of S corporation income. Also, losses sustained from sole proprietorships may be used against the other categories. Losses may not be used against other non-business-related income including wages, interest and dividends, and disposition of property. Current law only allows income

and losses to offset in the same category with no amount carried forward for future use.

In addition, a deduction for net losses calculated beginning with the 2012 tax year will be phased in over five years and deductible each year as follows:

2012	10%
2013	20%
2014	30%
2015	40%
2016 and thereafter	50%

Remaining non-deductible losses calculated each year will carry forward for 20 years. Losses that are carried forward can only offset income and losses from the same business-related category. For example, a loss carry forward related to a partnership can only be netted with partnership income and loss in the following year.

Please contact us if you believe you may benefit from these new business loss deduction and carryover rules.

Upcoming Events



Join The Curchin Group at the Firm's 6th Annual Curchin Open



The Curchin Group's 6th Annual Curchin Open, a nine-hole miniature golf tournament for charity, will take place indoors at Curchin's Red Bank office on **Wednesday, November 2, 2011 from 4:00 to 7:00 p.m.** Player fees are \$20 per person, which includes one round of golf, food and beverages. Teams of four can sign up for the \$100 per team Foursome Challenge (which includes four Fantasy Golf scratch-off cards). Winner of the Foursome Challenge competition is awarded a lunch for 10 from Readies Caterers!

Two local non-profit organizations will share the proceeds from the 6th Annual Curchin Open:

Big Brothers Big Sisters of Monmouth & Middlesex Counties,

dedicated to making a positive difference in the lives of children through professionally-supported mentor relationships. The children spend time with, obtain guidance from and build friendships with their Big Brother or Sister. The funds from The Curchin Group will go directly toward matching 10 children with their own caring Big Brother or Sister.

Prevention First, an organization which aims to improve the lives of Monmouth and Ocean County children by providing programs targeted at preparing children and their families for handling difficult situations, including violence and substance abuse. In the past year the organization has implemented three new programs focused on the problems of bullying. Funding from the Curchin Open will be used to support these programs as well as to help implement additional programs.

For further information about sponsoring the 6th Annual Curchin Open, please contact Peter Pfister at ppfister@curchin.com or at 732.747.0500, or visit the Curchin Web site at www.curchin.com.

Curchin Hosts Credit Union Breakfast Roundtable Event



Date: Tuesday, September 27, 2011
Registration and Networking: 8:15 a.m.
Program: 9:00 a.m.
Location: Hilton Woodbridge
120 Wood Avenue South
Iselin, NJ 08830

Topic: Allowance for Loan Losses: Current Trends, Techniques & Considerations

Who should attend?

Credit Union CEOs, CFOs and Accounting Managers

Make your reservations today by phone, fax or email to:

The Curchin Group, LLC
Phone: 732.747.0500
Fax: 732.747.7700
dgrossi@curchin.com



- **Curchin Partner Gives Presentation to State and National Credit Union Associations.** Managing Partner Robert C. Fouratt, CPA has had the pleasure of presenting recently to several state-wide and national credit union audiences on the topic of financial literacy for board members. Certain provisions of recently enacted NCUA final rule 701.4 focus on the financial skills required of federal credit union boards of directors. These provisions took effect July 27, 2011. Fouratt's presentation, entitled "Financial Literacy for Board Members – A Primer," discussed the basics of credit union financial statements, the analysis of financial statements, as well as how to control, monitor and mitigate business risks facing all credit unions. The topic was presented at the National Association of Credit Union Supervisory and Audit Committees conference in Seattle, Washington and to several audiences through the New Jersey Credit Union League.
- **Curchin Honored as Business of the Year by Northern Monmouth Chamber of Commerce.** The Curchin Group was honored in May 2011 at the Northern Monmouth Chamber of Commerce's (NMCC) Crystal Beacon Award Dinner. The Firm was bestowed with the 2011 Joseph Azzolina Business of the Year Award in recognition as a business whose practices reflect positively on the NMCC and its values. The NMCC was created to help local business owners network and promote their businesses to the Middletown Township area. The firm was chosen because of its outreach to the local community, including its annual Curchin Open, an indoor mini-golf tournament for charity. Since 2006 the Curchin Open has raised over \$63,000 for local charities.
- **Curchin Partner Peter Pfister Presents Scholarships to Four Local Students.** Curchin Partner and Howell Chamber of Commerce Education Chair, Peter Pfister, CPA presented scholarship awards to each of four high school students at the Chamber's *Howell Night*, an annual celebration commemorating the community's businesses, residents and growth.
- **Curchin Receives Community Service Award from Monmouth-Ocean Development Council.** The Firm was honored at the Monmouth-Ocean Development Council's (MODC) 46th Annual Silver Gull Awards Dinner. The 2011 Community Service Award in recognition of volunteerism, fundraising and community involvement was presented at the dinner. The MODC, located in Wall, NJ, is a consortium of business, government, professional, and community leaders in Monmouth and Ocean Counties.

The Firm was chosen as this year's honoree because of its demonstrated commitment to the local Monmouth and Ocean County communities.
- **Curchin Partner Attends INPACT Conference.** In June 2011, Peter Pfister, CPA, Senior Tax Partner, attended the *Partners Forum Spring Conference* hosted by INPACT Americas in New Orleans, LA. INPACT Americas is a nonprofit, internationally affiliated association of accounting firms. The Conference objective was designed to teach principles and skills necessary for the successful management of an accounting practice, including succession planning, mergers and acquisitions, and strategies to make the firm digitally secure.

Featured Employee: Daniel Geltzeiler



This summer, after graduating from Syracuse University with a Bachelor's degree in Accounting and Management, Daniel Geltzeiler began his career by joining The Curchin Group as an Intern. In this role, Dan supports Curchin's Partners with general tax work, auditing and trust accounting.

Dan was attracted to The Curchin Group because of its "just right" size and its cohesive group of professionals. He also has a strong interest in the industries that the Curchin Group serves, particularly construction and non-profit organizations. What Dan loves about working for The Curchin Group are the atmosphere and the people. "It is a very close-knit group of professionals who make me feel really comfortable. The Partners have made me feel right at home and are always willing to teach," says Dan.

After completing his summer internship, Dan will stay on board as a member of Curchin's professional staff. He also plans to begin working toward his CPA certification this coming fall. When he is not busy developing his accounting career, Dan enjoys going to the beach, snowboarding, playing ice hockey and building his stock portfolio. Fun fact: Dan is also the grandson of The Curchin Group's Founder, George V. Curchin!

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Celebrating over 50 years in Monmouth County, New Jersey, The Curchin Group helps small to mid-sized businesses and individuals reach their financial goals through providing a broad range of Assurance; Tax; Financial Planning; and Business Advisory Services. The firm is dedicated to giving solid financial advice, sustaining long-term relationships with its clients and employees and giving back to the surrounding community. For more information about Curchin, please contact Bob Fouratt at 732.747.0500 or bfouratt@curchin.com.

From left to right: Lynn Conover; Dave Ferullo; Peter Pfister; Bob Fouratt; Carolyn Kvalo.



The Curchin Group LLC

Assurance Services :: Tax :: Financial Planning :: Business Advisory

200 Schulz Drive, Suite 400 / Red Bank, NJ 07701-6745

Tel. 732.747.0500 / Fax. 732.747.7700

www.curchin.com / info@curchin.com

200 Schulz Drive, Suite 400
Red Bank, NJ 07701-6745

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