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SENT VIA ELECTRONIC MAIL

November 1, 2025

RE: REASONABLE COMPENSATION & END OF YEAR PAYROLL, SE HEALTH INSURANCE, PTET, RETIREMENT PROGRAMS – FORMAL NOTICE

Dear Client,

This is a formal notice to all C corporations and S corporations that you must process payroll for your annual salaries before 12/31 if you are not already on a regular payroll schedule.

Corporation officers are employees for federal employment tax purposes (Treas. Reg. §31.3121(d)-1(b)). Both C corporations and S corporations must pay reasonable wage compensation to their officers for services provided to the corporation via payroll. §162 of the Internal Revenue Code defines reasonable compensation as the amount that would ordinarily be paid for like services by like organizations under like circumstances (comparable to what other employers would pay for similar services). It considers both the reasonableness of the total amount paid and the services rendered. Payments to a shareholder-employee for services provided to a corporation are wages subject to employment taxes. The IRS may re-characterize distributions paid to a shareholder as salary if the distribution was paid in lieu of reasonable compensation (Rev. Rul. 74-44). Generally, reasonable compensation is lower than the net income of the business.

Owners who fail to pay themselves a reasonable salary supported by data and credible documentation or claim all of their income through shareholder distributions run the risk of audit and severe penalties from the IRS.

Failure to pay reasonable compensation will force us to disengage from return preparation and representation in the future. Under *IRC § 6694(b)* preparers can be subject to penalties starting at $5,000 for each instance of failing to make reasonable inquiries, reviewing client compensation, and proactively informing the client of the consequences of not complying with reasonable compensation.

We are available to help you determine reasonable compensation for your business and help you setup payroll. Once reasonable compensation is determined, we partner with **Gusto** to administer payroll. **Gusto** will handle all federal and state employment tax filing requirements which can be labor intensive to do on your own. For this reason alone, they are well worth their service fee. You can sign up for an account using our referral link and receive a discount when you run your first payroll: https://gusto.com/r/zachary7086

Please note, that while we partner with Gusto, you are responsible for running your own payroll. We offer limited payroll support including advisement and setup. Upon request we will calculate and process payroll on your behalf with written authorization for an additional fee (see *Payroll Processing Agreement*) We have numerous guides and resources to help you get started and Gusto provides amazing technical support to ensure you will be successful.

SE HEALTH INSURANCE >2% SHAREHOLDERS

If you are a greater than 2% owner of your S corporation, you can have your health insurance premiums paid by your business. Having the S corporation pay it directly results in a substantially better deduction than paying it out of pocket because it isn't limited like itemized deductions (Schedule A limits you to only deduct medical costs that exceed 7.5% of your AGI). When the S corporation pays the premiums directly or reimburses you, the amounts must be reported on your W-2 in Box 1 as taxable wages (and often in Box 14 for informational purposes), but they are not subject to FICA or FUTA payroll taxes. Instructions how to do this are provided by Gusto. If you've already paid your premiums out of pocket, it's not too late to fix this. The S corporation can reimburse you for the premiums, and your payroll provider (e.g., Gusto) can issue a payroll correction to include the amount in Box 1 of your year-end W2. As long as the premiums are ultimately paid by the S corporation and included in your taxable wages, you can claim the full deduction for self-employed health insurance on your Form 1040. This deduction is available even if you don't itemize and can include health, dental, and vision premiums for you, your spouse, and dependents. However, to qualify, you must not be eligible to participate in a subsidized health plan (like one offered through a spouse's employer), even if you choose not to enroll in it.

PTET (PASS-THROUGH ENTITY TAX)

PTET can provide federal tax savings for S corporations, partnerships, and LLCs filing as S corporations or partnerships. Each state has their own unique rules for electing into and paying PTET. We provide general information on PTET to all clients; however, advisement on such matters is not included in tax-preparation engagements. PTET necessitates additional planning beyond the scope of our standard tax-preparation engagement. It is imperative that clients desiring comprehensive PTET advisement engage us separately for that specific purpose as PTET suitability requires significant analysis and a review of up-to-date financial records. If you anticipate a net profit from your pass-through entity and would like to learn more about the potential tax savings PTET could provide your entity, please schedule a tax planning session. **Most of the PTET elections have strict deadlines and procedures for PTET participation and you must act timely. The CA safe harbor payment to participate (the greater of $1,000 or 50% of prior year elective tax paid) must be made by June 15, 2025. Other states have other deadlines and requirements.**

MANDARTORY RETIREMENT SAVINGS PROGRAMS – (CalSavers)

CA State law requires employers that don't offer their own retirement plan to facilitate CalSavers. If you employ one or more California-based employees (including yourself), and don't sponsor a qualified retirement plan, your business is required to register for CalSavers. Employers must also register their business with CalSavers and inform if exempt from already offering a qualified retirement plan. The deadline for employers with 5 or more employees was June 30, 2022. Employers with 1-4 employees must register by December 31, 2025. Failing to do so can lead to enforcement action and fines. Please see the FAQ for a list of qualified retirement plans at calsavers.com. Other states (OR, IL, CT, MD, CO, NJ) also mandate (or will soon VA, NY) retirement savings programs for their employees so be sure to check to make sure your entity is in compliance.

Tax preparation IS NOT tax planning. The end of the year is a great time to schedule a tax planning session to find ways we can save you money. These sessions include an analysis of prior year taxes and current year to date bookkeeping to find solutions to save your bottom line, including but not limited to income deferral, pension plans and retirement contributions, tax-exempt investments, additional deductions, and the use of legal entities. Please contact us today to schedule your tax planning session. Additionally, all entities should be using a double-entry accounting system. If you are in need of bookkeeping services, please contact our office to inquire about the bookkeeping solutions we offer. Waiting until tax time to get started is too late!

If you have any questions about payroll or what constitutes reasonable compensation, please don't hesitate to contact our office. ***If you are already running adequate payroll, please kindly disregard this message***. We look forward to the opportunity to serve you.

Sincerely,

Zachary Hellman, EA, CFE

P.S. Referrals always make the best clients and are greatly appreciated! If you or someone you know has an issue with paying their federal or state taxes and needs help resolving collection issues, please contact us today for assistance.