

Reasonable Compensation Case Study Scott Stone ~ Stone Concrete

Following is a Reasonable Compensation case study for Scott Stone. This case study follows Scott through his career and determines Reasonable Compensation for Scott at three different points in his career using the three different approaches recognized by the IRS.

Scott is the owner of Stone Concrete. His business specializes in concrete patios, sidewalks, driveways etc...



Scenario One:

Meet Scott Stone at age 30. Scott owns Stone Concrete, an S Corp with seven full-time employees including Scott and annual gross income of \$250,000.

Because Scott's business would be considered a small business, we will be determining Scott's Reasonable Compensation using the **Cost Approach** (AKA the multiple hats approach). This approach tends to work best with small businesses where the owner performs multiple duties (wears multiple hats).

We have gathered the following information on Scott and his business:

How many hours do you work per week on average? 40+				
State your business is located Illinois				
County or township your business is located Cook				
Yes/No	Title	Definition	Time %	Proficiency
X	Sales Representatives	Sell goods or services for wholesalers or manufacturers to businesses or groups of individuals. Work requires substantial knowledge of items sold.	10%	Below Average
X	Bookkeeper	Compute, classify, and record numerical data to keep financial records complete. Perform any combination of routine calculating, posting, and verifying duties to obtain primary financial data for use in maintaining accounting records. May also check the accuracy of figures, calculations, and postings pertaining to business transactions recorded by other workers.	10%	Below Average
X	Purchasing Clerk	Compile information and records to draw up purchase orders for procurement of materials and services.	5%	Average
X	Business Office Manager	Plan, direct, or coordinate one or more administrative services of an organization, such as records and information management, mail distribution, facilities planning and maintenance, custodial operations, and other office support services.	15%	Average
Please list any specialized tasks which fall outside the common tasks that you've already selected from. You may add as many specialized tasks as you need to adequately account for all the other tasks you perform for your business regularly throughout the year and then rate your skill level for each task added. (Example: Veterinarian; Hair Stylist; Pastry Chef; Etc...)				
	Title	Description	Time %	Proficiency
	Concrete Finisher	Smooth and finish surfaces of poured concrete, such as floors, walks, sidewalks, roads, or curbs using a variety of hand and power tools. Align forms for sidewalks, curbs, or gutters; patch voids; and use saws to cut expansion joints.	30%	Above Average
	Maintenance Mechanic	Perform work involving the skills of two or more maintenance or craft occupations to keep machines, mechanical equipment, or the structure of an establishment in repair. Duties may involve pipe fitting; boiler making; insulating; welding; machining; carpentry; repairing electrical or mechanical equipment; installing, aligning, and balancing new equipment; and repairing buildings, floors, or stairs.	30%	Above Average
			100%	TOTAL

After inputting the above data into RCReports the following report is produced:

(Following are pages 1-2 of what is typically a 5-7 page report that would include additional information on methodology, court cases, IRS info and sample corporate minutes. View the entire report [HERE](#))



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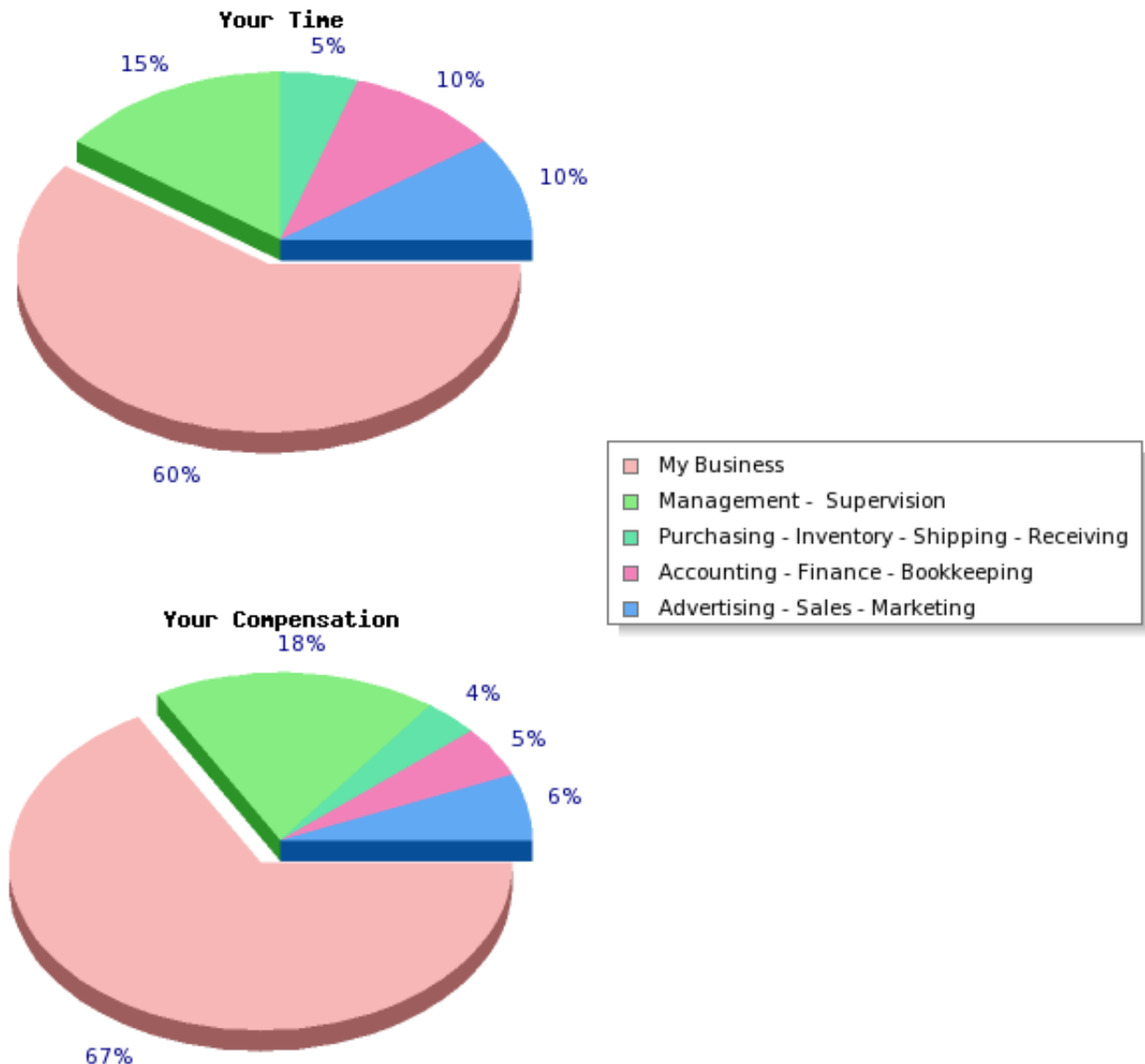
Report for Scott Stone of Stone Concrete, Inc.

Your estimated annual Reasonable Compensation: \$68,788

Thank you for entrusting Sam Miller of Potomac Tax and Valuation, PC with your Reasonable Compensation analysis. This report provides a reasonable estimate of the value of services rendered to your S Corporation based on your responsibilities and the duties that you perform annually. Reasonable Compensation is defined by the IRS as "The value that would ordinarily be paid for like services by like enterprises under like circumstances".

The calculated salary of **\$68,788** was determined to be reasonable compensation based on the type of work performed, the skill level of the work performed and the number of hours the work is performed annually. You told us that you work **2080** hours per year in **Cook County, IL**. Our analysis indicates the annual salary of \$68,788 would be a reasonable cost to hire employee(s) to perform the duties and responsibilities that you currently perform.

Potomac Tax and Valuation, PC recommends completing a reasonable compensation report annually.



*Annual Salary and Reasonable Compensation are used interchangeably in this report.
All salary and reasonable compensation figures are expressed annually and in U.S. dollars.*



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Report for Scott Stone of Stone Concrete, Inc.

Advertising - Sales - Marketing

10% of
your time

208 hours
per year

6.4% of
your comp.

Task	Proficiency	Category	Overall	Hours	Wage	Annual
Sales Representatives	Below Avg.	100%	10%	208.0	\$ 21.18	\$ 4,405

Accounting - Finance - Bookkeeping

10% of
your time

208 hours
per year

4.89% of
your comp.

Task	Proficiency	Category	Overall	Hours	Wage	Annual
Bookkeeper	Below Avg.	100%	10%	208.0	\$ 16.16	\$ 3,361

Purchasing - Inventory - Shipping - Receiving

5% of
your time

104 hours
per year

3.57% of
your comp.

Task	Proficiency	Category	Overall	Hours	Wage	Annual
Purchasing Clerk	Average	100%	5%	104.0	\$ 23.61	\$ 2,455

Management - Supervision

15% of
your time

312 hours
per year

18.29% of
your comp.

Task	Proficiency	Category	Overall	Hours	Wage	Annual
Business Office Manager	Average	100%	15%	312.0	\$ 40.33	\$ 12,583

My Business

60% of
your time

1,248 hours
per year

66.85% of
your comp.

Task	Proficiency	Category	Overall	Hours	Wage	Annual
Concrete Finisher	Above Avg.	50%	30%	624.0	\$ 45.21	\$ 28,211
Maintenance Mechanic	Above Avg.	50%	30%	624.0	\$ 28.48	\$ 17,772

Scenario Two:

Meet Scott Stone at age 45. Stone Concrete has grown significantly, is still an S Corp and has grown to 35 employees and 7 million in annual gross revenue. Scott's primary job function for Stone Concrete is now CEO.

Because Scott's business would be considered a medium business, we will be to determining Scott's Reasonable Compensation using the **Market Approach** (AKA the industry comparison approach). This approach tends to work best when the company is larger, more mature and the business owner is acting in a management capacity.

We have gathered the following information on Scott and his business:

In order to help us build your Reasonable Compensation profile, tell us a little more about yourself and your business:	
Industry	Specialty trade contractors
Occupation	CEO
State	Illinois
Metro area	Chicago
Number of employees	35
Adjusted Gross Profit	3.5 million
Business performance versus peers	Above average
Owner experience versus peers	High
Hours worked per week on average	55

After inputting the above data into RCReports the following report is produced:

(Following is the first page of what is typically a five page report that would include additional information on methodology, court cases, IRS info and sample corporate minutes View the entire report [HERE](#))



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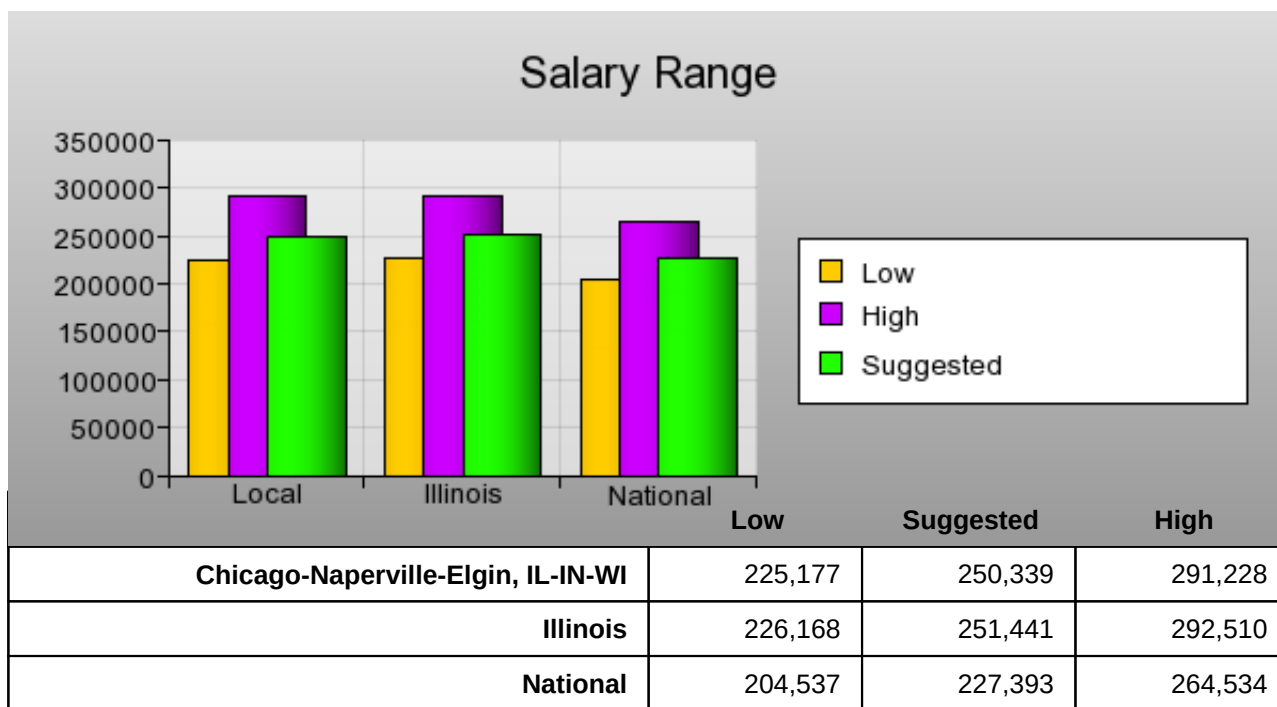
Report for Scott Stone of Stone Concrete, Inc.

Your estimated annual Reasonable Compensation: \$250,339

Thank you for entrusting Paul Hamann of Potomac Tax and Valuation, PC with your Reasonable Compensation analysis. This report provides a reasonable estimate of the value of services rendered to your S Corporation based on your responsibilities and the duties that you perform annually. Reasonable Compensation is defined by the IRS as "The value that would ordinarily be paid for like services by like enterprises under like circumstances".

Your suggested salary range: \$204,537 to \$292,510 with a suggested salary of \$250,339 was determined to be Reasonable Compensation based on your role in the company, industry, size of the business, time devoted to the business, your experience and location. Any wage selected within the suggested range or expanded geographical area(s) is acceptable and within a 90% confidence interval.

Potomac Tax and Valuation, PC recommends completing a Reasonable Compensation report annually.



Scenario Three:

Meet Scott at age 55. Ten years earlier Scott started a new company called Stone Technologies, a C Corp. Scott has developed multiple new technologies for the concrete industry and has patented them.

Scott is the only employee of Stone Technologies, and Scott would best be classified as an inventor. His business revenue is growing at an exponential rate, and we are having a very difficult time finding comparable wage data for Scott. Because of this we are going to be determining Scott's Reasonable Compensation using the **Income Approach** (AKA the independent investors test).

This approach does not rely on comparable wage data, but instead relies on a simple algorithm used by the IRS. This approach tends to work best for what we term outliers, these are business owners who have a unique occupation or who are achieving results significantly better than their peers. Therefore comparability data is not available or appropriate to use.

We have gathered the following information on Scott's business:

In order to help us build your Reasonable Compensation profile, tell us a little more about yourself and your business:	
Estimated FMV beginning of the year	6,000,000
Estimated increase in FMV by year end	1,750,000.00
Target return (independent investor rate)	20%

After inputting the above data into RCReports the following report is produced (included 1 of 5 pages):

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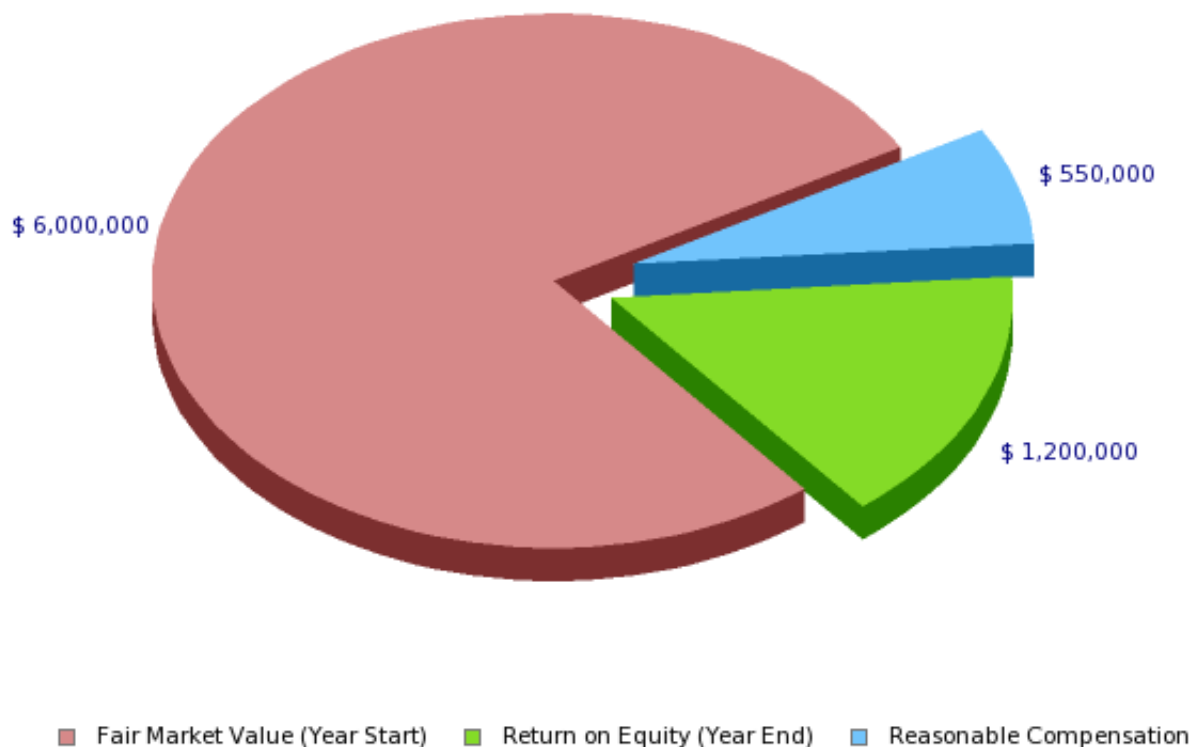
Report for Scott Stone of Stone Technologies, Inc.

Your estimated annual Reasonable Compensation: \$550,000

Thank you for entrusting Sam Miller of Potomac Tax and Valuation, PC with your Reasonable Compensation analysis. This report provides a reasonable estimate of the value of services rendered to your C Corporation based on your responsibilities and the duties that you perform annually. Reasonable Compensation is defined by the IRS as "The value that would ordinarily be paid for like services by like enterprises under like circumstances."

The calculated salary of \$550,000 was determined to be Reasonable Compensation based on the increase in the Fair Market Value of your company over a one year time frame and a Return on Investment of 20.00% in conjunction with your efforts.

Potomac Tax and Valuation, PC recommends completing a Reasonable Compensation report annually.



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