# Year 1 ~ Letter 1

Mr. Tom Jones

111 First Street

Anytown, CO 88888

Dear Tom,

As your tax advisor, I need to alert you to your responsibility to accurately determine and document your Reasonable Compensation for the services you provide to your business. Reasonable Compensation is the salary or wage that you, a shareholder-employee of an S Corp, pay yourself for the work you perform for your company.

The IRS requires that all shareholders of S Corps who perform services for their company pay themselves Reasonable Compensation, and it needs to be paid prior to taking any distributions. There are two ways to think about Reasonable Compensation:

1. Replacement Cost: What would it cost your company to pay another person(s) to provide all the services you currently provide?
2. Fair Market Value: What would other businesses in your community pay you for the services you currently provide to your company?

The IRS has updated its [guidelines](http://www.rcreports.com/pro/docs/irs.fs.2008.25.pdf). It is more important than ever that you **research and document** how you determined your Reasonable Compensation figure.

We have tools available to make it easy for you to accurately determine your Reasonable Compensation figure. Please contact me if you would like to discuss this issue further or to have me complete a Reasonable Compensation Report for you.

A Reasonable Compensation Report is an independent unbiased report that establishes your Reasonable Compensation using criteria outlined by the IRS and Courts and provides a defensible position to an IRS challenge.

The best time to establish your Reasonable Compensation figure is now, before an IRS examination. Reasonable Compensation has become an IRS hot button and we have been told to expect an increase in examinations of S Corps:

* S Corp audits up 14% in 2015
* June 2016: IRS announces it is focusing more resources on S-Corps.

A Reasonable Compensation challenge can be costly. Typically, taxes, penalty, and interest are more than double the original tax that would have been owed – plus costs for amending returns.

Please call me at your convenience so you can take the necessary steps to protect yourself on this issue.

Sincerely,

(CPA name)

(CPA Firm)

# Year 2 ~ Letter 2

Mr. Tom Jones

111 First Street

Anytown, CO 88888

Dear Tom,

Last year I alerted you to your responsibility to accurately determine and document your Reasonable Compensation for the services you provide to your S Corp. (attached)

I wanted to make you aware that this year, our firm is now **requiring** *Independent* research and documentation to support Reasonable Compensation for all our S Corp clients. This area of compliance has increasingly become a hot spot with the IRS. Beginning in 2005 the IRS began studying the issue and since 2005 has changed their enforcement and compliance strategy and updated their [guidelines](http://www.rcreports.com/pro/docs/irs.fs.2008.25.pdf). Through a series of court cases and IRS notices, we have seen this issue become increasingly pursued by the IRS and local taxing authorities over the last few years.

This means that it is now more important than ever that you have **research and documentation** to support your Reasonable Compensation figure.

We have tools available that will provide the Independent research and documentation we require. I urge you to have our firm complete a Reasonable Compensation Report for you.

A Reasonable Compensation Report is a detailed report that establishes your Reasonable Compensation using criteria outlined by the IRS and Courts and provides a defensible position to an IRS challenge.

We do not require you to have a Reasonable Compensation Report completed by our firm. However, if you don’t have us complete a report for you, you will need to provide us with sufficient documentation to support your Reasonable Compensation figure.

A Reasonable Compensation challenge can be costly. Typically, taxes, penalty, and interest are more than **double** the original tax that would have been owed – plus costs for amending returns.

Please call me at your convenience so you can take the necessary steps to protect yourself on this issue.

Sincerely,

(CPA name)

(CPA Firm)

# Year 3 ~ Letter 3

Mr. Tom Jones

111 First Street

Anytown, CO 88888

Dear Tom,

For the last two years I have alerted you to your responsibility to accurately determine and document your Reasonable Compensation for the services you provide to your S Corp. (attached)

Last year, I notified you that our firm now **requires** *Independent* research and documentation to support Reasonable Compensation for all our S Corp clients. Unfortunately we did not receive the required documentation from you last year.

**I will no longer be able to complete your tax returns in the future** without the required documentation. Not only has the risk increased for you, the tax payer, but the IRS is now holding Tax Preparers responsible. The IRS has made it their policy to assess preparer penalties ($5,000 minimum) on the preparer, when a Reasonable Compensation figure has been deemed Unreasonable.

We have tools available that will provide the Independent research and documentation we require. I urge you to have our firm complete a Reasonable Compensation Report for you.

A Reasonable Compensation Report is a detailed report that establishes your Reasonable Compensation using criteria outlined by the IRS and Courts and provides a defensible position to an IRS challenge.

We do not require you to have a Reasonable Compensation Report completed by our firm. However, if you don’t have us complete a report for you, you will need to provide us with sufficient documentation to support your Reasonable Compensation figure.

This area of compliance has increasingly become a hot spot with the IRS. Beginning in 2005 the IRS began studying the issue and since 2005 has changed their enforcement and compliance strategy and updated their [guidelines](http://www.rcreports.com/pro/docs/irs.fs.2008.25.pdf). Through a series of court cases and IRS notices, we have seen this issue become increasingly pursued by the IRS and local taxing authorities over the last few years.

A Reasonable Compensation challenge can be costly for both of us and our firm can no longer accept the risk. Typically, taxes, penalty, and interest are more than **double** the original tax that would have been owed – plus costs for amending returns.

Please call me at your convenience so you can take the necessary steps to protect yourself on this issue. I hope to remain your tax preparer for the upcoming year. However, I understand if you prefer not to meet our new requirements, in which case I wish you luck in finding the right tax preparer to meet your needs.

Sincerely,

(CPA name)

(CPA Firm)