

Summary of Court Factors used to “Stress Test” Reasonable Compensation Figures

Source: [IRS Fact Sheet 2008-25: Wage Compensation for S Corporation Officers](#)

Nine factors considered by the courts in determining reasonable compensation:

1. Training and experience
2. Duties and responsibilities
3. Time and effort devoted to the business
4. Dividend history
5. Payments to non-shareholder employees
6. Timing and manner of paying bonuses to key people
7. What comparable businesses pay for similar services
8. Compensation agreements
9. The use of a formula to determine compensation

Source: [LabelGraphics, Inc. v. Commissioner, T.C. Memo 1998-343 \(Sept. 28, 1998\)](#)

Five factors considered by the courts in determining reasonable compensation:

1. The employee's role in the company;
2. A comparison of the compensation paid to the employee with the compensation paid to similarly situated employees in similar companies;
3. The character and condition of the company;
4. Whether a conflict of interest exists that might permit the company to disguise dividend payments as deductible compensation;
5. Whether the compensation was paid pursuant to a structured, formal, and consistently applied program.

Source: [Brewer Quality Homes, Inc. v. Commissioner, T.C. Memo 2003-200 \(July 10, 2003\)](#)

Ten factors considered by the courts in determining reasonable compensation:

1. The person's qualifications;
2. The nature, extent, and scope of the person's work;
3. The size and complexities of the business;
4. A comparison of salaries paid with gross income and net income;
5. The prevailing general economic conditions;
6. A comparison of salaries with distributions to stockholders;
7. The prevailing rates of compensation for comparable positions in comparable concerns;
8. The salary policy of the taxpayer as to all persons;
9. In the case of small corporations with a limited number of officers the amount of compensation paid to the particular person in previous years;
10. Whether the corporation provided the person with a pension or profit-sharing plan.