

**This sample report has been intentionally redacted to protect proprietary methodologies and compensation data.**

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**Reporting Date**

Friday, February 6, 2026

CLIENT LOGO

**Company Name**

Company Address

Company Phone Number

Company Email Address

Reasonable Compensation Calculation

SAMPLE - REDACTED VERSION

*prepared for*

Officer Name

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## Executive Summary

This Reasonable Compensation Calculation Report documents the methodology used to determine appropriate officer compensation under Internal Revenue Code §162(a)(1).

The analysis evaluates the officer's actual services to the company, the time devoted to those services, and prevailing market compensation for comparable roles within the relevant geographic labor market.

The calculation applies a blended approach using both the market and cost (replacement) methods. This includes:

**Allocating the officer's weekly hours across functional job duties**

**Applying market-based wage rates to each duty**

**Capping total hours at 40 per week**

**Summing duty-based compensation into a total annual figure**

Based on this methodology, the officer's calculated reasonable compensation is:

OFFICER REASONABLE COMPENSATION SALARY AMOUNT

\$XX,XXX,XXX

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## IRS Authority & Legal Framework for Reasonable Compensation

Reasonable compensation for S corporation officers is governed by Internal Revenue Code §162(a)(1), which allows a deduction for "a reasonable allowance for salaries or other compensation for personal services actually rendered." The Internal Revenue Service has consistently emphasized that S corporation shareholder-officers must be paid reasonable compensation for services provided to the business before distributions are made.

The IRS has issued guidance clarifying that officer compensation must reflect what would ordinarily be paid for similar services by similar enterprises under similar circumstances. This requirement applies regardless of whether the officer chooses to characterize payments as distributions rather than wages.

### IRS Administrative Guidance

The Internal Revenue Service addressed reasonable compensation for S corporation officers in Fact Sheet FS-2008-25, stating that:

*"S corporations must pay reasonable compensation to shareholder-employees in return for the services they perform for the corporation before non-wage distributions may be made."*

The Fact Sheet further explains that the determination of reasonable compensation depends on the facts and circumstances of each case and that no single factor is determinative.

## Judicial Precedent

U.S. courts have consistently upheld the IRS's authority to recharacterize S corporation distributions as wages when officer compensation is unreasonably low. Key cases include:

**Watson v. United States (668 F.3d 1008, 8th Cir. 2012):** The court ruled that a CPA who paid himself minimal wages while taking substantial distributions was undercompensated relative to market standards. The IRS's recharacterization of distributions as wages was upheld.

**Elliotts, Inc. v. Commissioner (716 F.2d 1241, 9th Cir. 1983):** The court articulated a multi-factor framework for evaluating reasonable compensation, emphasizing the importance of duties performed, time devoted, and compensation paid for comparable services.

**JD & Associates, Ltd. v. United States:** Reinforced that reasonable compensation must reflect the value of services actually rendered and cannot be artificially suppressed to avoid employment taxes.

These cases establish that reasonable compensation must be determined using an objective, supportable methodology that considers the officer's role, responsibilities, and market comparables.

## Analytical Framework Applied in This Report

Consistent with IRS guidance and judicial precedent, reasonable compensation analyses commonly rely on three recognized approaches:

### Market Approach

Compares compensation paid to the officer with compensation paid for similar roles in similar industries and geographic markets.

### Cost (Replacement) Approach

Evaluates the cost to replace the services performed by the officer by allocating hours worked across functional job duties and applying market-based wage rates to each duty.

### Income Approach / Independent Investor Test

Assesses whether an independent investor would receive a reasonable return on investment after payment of officer compensation.

This report applies a blended methodology using the market approach and cost approach, consistent with accepted valuation and compensation practices. The analysis focuses on the services actually performed by the officer, the time devoted to those services, and market compensation data for comparable positions within the relevant geographic area.

### Purpose of This Report

This report is intended to serve as contemporaneous documentation supporting the officer's compensation level for federal and state tax reporting purposes. It is designed to assist the taxpayer and their tax advisor in demonstrating compliance with IRS reasonable compensation requirements in the event of an examination.

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# IRS Multi-Factor Reasonable Compensation Analysis

The Internal Revenue Service and U.S. courts have consistently held that reasonable compensation determinations must be based on a review of all relevant facts and circumstances. No single factor is determinative. Instead, reasonable compensation is evaluated by considering multiple quantitative and qualitative factors related to the officer's services, the business, and prevailing market conditions.

This report applies a multi-factor framework consistent with IRS guidance and judicial precedent. Certain factors are quantitatively evaluated using data inputs and market benchmarks, while others require professional judgment and taxpayer-specific analysis beyond the scope of this report.

## Factors Quantitatively Evaluated in This Report

The following factors are directly incorporated into the calculation methodology used in this report.

### 1. Nature and Scope of Duties Performed

The officer's compensation was evaluated based on the specific services performed for the company. Job duties were categorized by functional role, including administrative, managerial, executive, and core business activities.

Compensation attributable to each role was determined independently to ensure wages reflect payment for services rendered rather than ownership interest, consistent with IRS requirements.

### 2. Time Devoted to the Business

The analysis considers the number of hours the officer devotes to the business on a recurring basis. Hours were allocated across functional job duties based on representations provided by the officer.

For purposes of this analysis, total officer hours were capped at forty (40) hours per week to reflect a standard full-time workload and to avoid overstating compensation attributable to excessive or non-routine hours.

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### 3. Geographic Location and Labor Market Conditions

Market-based wage rates applied in this report reflect compensation data for comparable positions within the relevant geographic labor market in which the officer primarily performed services.

Geographic considerations were incorporated to account for regional differences in compensation levels, cost of living, and labor market conditions.

Confidential Sample Report  
Redacted for Demo Purposes Only  
Not Valid for Tax Filing/Reliance

## Compensation Calculation

| DUTIES                          | HOURS | SALARY   |
|---------------------------------|-------|----------|
| Administrative/Customer Service | 5.00  | \$XX.XX  |
| Sales/Marketing                 | 5.00  | \$XX.XX  |
| Finance/Accounting              | 5.00  | \$XX.XX  |
| Managerial                      | 8.00  | \$XXX.XX |
| Human Resources                 | 6.00  | \$XXX.XX |
| Main Business Services          | 5.00  | \$XXX.XX |
| CEO                             | 6.00  | \$XXX.XX |

**Note:** Total hours are capped at 40 per week.

# Practitioner Reliance & Limitations

## Practitioner Reliance

This report was prepared using information provided by the taxpayer and/or the taxpayer's authorized representative. The calculations and conclusions contained in this report are based on representations regarding the officer's job duties, time devoted to the business, and other factual inputs supplied at the time the report was generated.

This report is intended to be used by the taxpayer and their tax advisor as supporting documentation in evaluating officer compensation for federal and state tax reporting purposes. Tax practitioners may rely on this report as one component of a broader reasonable compensation analysis when used in conjunction with their professional judgment and knowledge of the taxpayer's overall financial and operational circumstances.

This report does not replace the need for professional review, nor does it constitute legal, tax, or valuation advice independent of such review.

## Scope Limitations

The scope of this report is limited to a quantitative analysis of certain objective factors commonly considered in reasonable compensation determinations, including:

**Functional job duties performed by the officer**

**Time devoted to those duties**

**Geographic labor market compensation data**

This report does NOT independently verify:

**The accuracy or completeness of information provided by the taxpayer**

**The officer's credentials, experience, or professional background**

**Company financial performance, profitability, or shareholder returns**

**Distribution history or application of the independent investor test**

**Compliance with payroll tax, employment tax, or corporate governance requirements**

Certain qualitative factors relevant to reasonable compensation—such as officer qualifications, company size and complexity, and the relationship between compensation and business performance—require professional evaluation and are outside the scope of this report.

### **No Audit or Attestation**

This report does not constitute an audit, review, attestation, or agreed-upon procedures engagement. No assurance is provided regarding the outcome of any IRS or state tax examination. Tax authorities may reach conclusions that differ from those reflected in this report based on additional facts, documentation, or interpretations of law.

## Taxpayer Responsibility

The taxpayer is responsible for:

**Maintaining adequate records to substantiate officer duties and hours worked**

**Ensuring compensation paid reflects services actually rendered**

**Retaining supporting documentation, including time logs and payroll records**

The taxpayer acknowledges that reasonable compensation determinations are inherently fact-specific and subject to examination by taxing authorities.

## Intended Use

This report is intended solely for use by the taxpayer and their tax advisor in connection with evaluating officer compensation. It may not be relied upon by third parties for any other purpose without the express consent of the preparer.

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## Taxpayer Acknowledgment & Officer Certification

Please review and confirm the following statements:

I confirm that the information provided regarding my job duties and responsibilities accurately reflects the services I performed for the company during the period covered by this report.

I confirm that the allocation of hours across job functions reasonably represents the time I devoted to each activity and reflects my normal and recurring workload.

I confirm that the total hours reported do not include personal activities or non-routine services and are limited to services performed for the business.

I understand that this Reasonable Compensation Report was prepared using information I provided and that the accuracy of the results depends on the accuracy and completeness of that information.

I understand that reasonable compensation determinations are based on the specific facts and circumstances of the taxpayer and are subject to review by the Internal Revenue Service or other taxing authorities.

I acknowledge that I am responsible for maintaining adequate records to substantiate my job duties, hours worked, and compensation paid, including time logs and payroll records, as appropriate.

I understand that this report is intended to be used as supporting documentation in consultation with my tax advisor and does not constitute legal, tax, or valuation advice.

I understand that this report does not guarantee the outcome of any federal or state tax examination.

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## Appendix A: Sample Officer Time Log

This sample is provided to illustrate an acceptable method for documenting officer time devoted to the business across all job function categories used in the Reasonable Compensation Report. Taxpayers may use a similar format to substantiate hours worked and duties performed. Logs should reflect the officer's normal and recurring activities.

**Important:** Logs do not need to be minute-by-minute. Reasonable estimates maintained contemporaneously and in good faith are generally sufficient.

### Officer Time Log — Sample (All Job Function Categories)

**Officer Name:** John Smith

**Company Name:** XYZ Veterinary Group

**Tax Year:** 2025

**Reporting Period:** January 6 – January 10, 2025

| Date       | Job Function                      | Description of Activities  | Hours |
|------------|-----------------------------------|--|-------|
| 01/06/2025 | Main Business Services            | Client appointments, examinations, and procedures                      | 6.5   |
| 01/06/2025 | Administrative / Customer Service | Responded to client emails and phone messages; reviewed daily schedule | 1.0   |
| 01/07/2025 | Main Business Services            | Client services and treatment procedures                               | 7.0   |
| 01/07/2025 | Sales / Marketing                 | Reviewed website content; approved promotional materials               | 0.5   |
| 01/08/2025 | Finance / Accounting              | Reviewed monthly financial statements; discussed AR/AP with bookkeeper | 1.0   |

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| Date       | Job Function                      | Description of Activities                                   | Hours |
|------------|-----------------------------------|---|-------|
| 01/08/2025 | CEO / Executive Oversight         | Strategic planning; evaluated pricing and staffing needs    | 1.0   |
| 01/09/2025 | Human Resources                   | Interviewed prospective hire; reviewed employee performance | 0.5   |
| 01/09/2025 | Managerial                        | Oversaw staff workflow; resolved operational issues         | 1.0   |
| 01/10/2025 | Main Business Services            | Client appointments and core service delivery               | 6.0   |
| 01/10/2025 | Administrative / Customer Service | Vendor coordination; compliance paperwork                   | 0.5   |

**Total Hours for Reporting Period: 25.5**

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