Reemployment Tax
Gross Wages to be Reported

Shareholders who are also employees of a subchapter s corporation (“S corporation”), or of a limited liability company (LLC) which elected to be treated as an S corporation for federal income tax purposes, may receive both wages and distributions.

To reduce federal and state employment taxes, an S corporation might misclassify most of the amount given to a shareholder/officer (who performs services for the S corporation or LLC treated as an S corporation) as:

- distributions of cash or property;
- draws as a business expense;
- business expenses for payments of personal expenses of the shareholder-employee;
- business expenses for use of business assets (although the shareholder-employee used some of the business assets for personal use);
- amounts paid to an independent contractor; or as
- a loan to the shareholder,

rather than classify a sufficient amount as wages.

However, the amount of wages reported paid to the shareholder-employee must be reasonable for the services being performed or the Internal Revenue Service (IRS) and/or the Department of Revenue (Department) may reclassify as wages some or all of the amounts misclassified as distributions, etc.

Sections 3121(a) and 3306(b), Internal Revenue Code (IRC) generally define “wages,” for federal employment tax purposes, as all remuneration for employment. Pursuant to ss. 31.3121(a)-1(b) and 31.3306(b)-1(b), Code of Federal Regulations (CFR), the form of the payment is immaterial. Under s. 3121(d), IRC, the term “employee” includes an officer of a corporation. Section 31.3121(d)- (1)(b), CFR, provides an exception for officers who do not provide any services (or provide only minor services) and who neither receive nor are entitled to receive remuneration.

The following court decisions held that the IRS has the authority to (and it is appropriate to) reclassify purported S corporation cash distributions to wages when the wages reported paid to a shareholder-employee are unreasonably low:

- *Joseph Radtke S.C. v. United States*, 895 F.2d 1196 (7th Cir. 1990);
- *Spicer Accounting, Inc. v. United States*, 918 F.2d 90 (9th Cir. 1990);
- *Joly vs. Commissioner*, 211 F.3d 1269 (6th Cir., 2000);
In Veterinary Surgical Consultants, P.C., v. Commissioner of Internal Revenue, the court clarified that “an employer cannot avoid Federal employment taxes by characterizing compensation paid to its sole director and shareholder as distributions of the corporation’s net income, rather than wages.”

In Revenue Rule 74-44, 1974-1 CB 287, 1974 WL 34866 (IRS RRU), the IRS concluded that (amounts classified as) dividends received by an S corporation's two sole shareholders were wages for which the corporation was liable for FICA, FUTA and income tax withholding.

Rule 73B-10.023, Florida Administrative Code, provides:

(3) Reporting Wages Paid. Wages are considered paid when:
   (a) Actually received by the worker; or
   (b) Made available to be drawn upon by the worker; or
   (c) Brought within the worker's control and disposition, even if not possessed by the worker.

In determining an amount which would be considered reasonable compensation, a wage amount of zero is unreasonable and a wage amount below minimum wage for the hours worked is unreasonable.


The instructions to the Form 1120S, U.S. Income Tax Return for an S Corporation, state "Distributions and other payments by an S corporation to a corporate officer must be treated as wages to the extent the amounts are reasonable compensation for services rendered to the corporation."

The amount of the compensation will never exceed the amount received by the shareholder either directly or indirectly. However, if cash or property or the right to receive cash and property did go to the shareholder, a salary amount must be determined and the level of salary must be reasonable and appropriate.

There are no specific guidelines for reasonable compensation in the Code or the Regulations. The various courts that have ruled on this issue have based their determinations on the facts and circumstances of each case.

In their fact sheet, the IRS lists the following factors considered by the courts in determining reasonable compensation:

- training and experience;
- duties and responsibilities;
- time and effort devoted to the business;
- dividend history;
- payments to non-shareholder employees;
• timing and manner of paying bonuses to key people;
• what comparable businesses pay for similar services;
• compensation agreements; and
• use of a formula to determine compensation.


The Unemployment Insurance Compensation Program is a federal program, partially administered by the states.

Although reemployment tax is due only on the taxable wage base each year (which was $7,000 prior to 2012, $8,000 for 2012 – 2014, returning to $7,000 for 2015 and later years, unless changed by legislation), not reporting a reasonable wage amount:
• may impact a shareholder-employee’s ability to receive reemployment benefits. Per ss. 443.091(1)(g) and 443.111(2), F.S., an unemployed individual must have sufficient wages reported to be considered eligible for benefits and to have a benefit year established;
• understates federal employment taxes; and
• may reduce the deductible contributions to the shareholder-employee’s pension account.

Gross wages (a/k/a “earned income” per s. 443.036(16), F.S.) which are not specifically exempt under s. 443.1217(2), F.S., should be reported for each employee on the Employer’s Quarterly Report (Form RT-6).

Particularly when the Department is auditing an employer for reemployment tax, the auditor will verify the gross wage amount.

The following is a list of some of the Final Orders issued to subchapter S corporations (or to LLCs treated for federal income tax purposes as subchapter S corporations) by the Department of Economic Opportunity (DEO), in which a Special Deputy ruled that the Department correctly reclassified to wages amounts which had originally been classified as distributions, etc.:

A-1 Detailing, Inc., d/b/a Correct Colors v. Department of Economic Opportunity, Case No. 0024 0300 43-02 (Fla. Dep’t of Ec. Op. 2015) - annual wages of $15,138 were reported for the sole shareholder/officer (who performed services for the corporation) and were increased to $19,638 by reclassifying as wages $4,500 originally classified as dividends;

Gearhart, Inc. v. Department of Economic Opportunity, Case No. 2015-0023 1570 40-02 (Fla. Dep’t of Ec. Op. 2015) - annual wages of $12,000 were reported for the sole shareholder/officer (who performed services for the corporation) but more than $12,000 had been taken as “draws.” The $1,058 ordinary income on Schedule K-1 plus a $150 expense were reclassified as wages;

Protective Water Proofing, Inc. v. Department of Economic Opportunity, Case No. 2012-93681L (Fla. Dep’t of Ec. Op. 2013) - no wages were reported for the sole shareholder/officer (who performed services for the corporation) but “draws” of $34,559.91 had been paid to the officer. The “draws” were reclassified as wages;

T W Moody Painting v. Department of Economic Opportunity, Case No. 2012-86266L (Fla. Dep’t of Ec. Op. 2012) - annual wages of $5,000 were reported for the shareholder/officer (who
performed services for the corporation) but the officer also received $4,229.77 of distributions, which were reclassified as wages;

*Hemisphere Title Company v. Department of Economic Opportunity*, Case No. 2011-119951L (Fla. Dep’t of Ec. Op. 2011) - annual wages of $6,500 were reported for the shareholder/officer (who performed services for the corporation) but the $35,399 amount of ordinary income reported for the individual on the federal Schedule K-1 was reclassified as wages; and

*Stormwise South Florida, Inc. v. Department of Economic Opportunity*, Case No. 2011-113967L (Fla. Dep’t of Ec. Op. 2011) – no wages were reported for the shareholder/officer (who performed services for the corporation) but the $23,622 amount of ordinary income reported for the individual on the federal Schedule K-1 was reclassified as wages.


Therefore, if the Department determines that the amount of gross wages reported on a RT-6 report is not reasonable compensation for the services provided, but the shareholder-employee received other amounts misclassified as dividends, draws, payment of personal expenses, loans to shareholders, etc., the Department may correct the misclassification of amounts to wages so that the wage amount represents reasonable compensation.

In addition to using the IRS guidelines mentioned above, to arrive at the amount of reasonable compensation for the shareholder-employee, the Department may review:

- *Florida Occupational Employment and Wages* by DEO;
- classified ads in websites online;
- classified ads in newspapers and in industry journals; and
- any other available resources,

to estimate what amount of wages would be considered “reasonable compensation.”

**For More Information**

This document is intended to alert you to the requirements contained in Florida laws and administrative rules. It does not by its own effect create rights or require compliance.

For forms and other information, visit our website at [www.myflorida.com/dor](http://www.myflorida.com/dor) or call Taxpayer Services, 8:00 a.m. to 7:00 p.m., ET, Monday through Friday, excluding holidays, at 800-352-3671.

For a detailed written response to your questions, write the Florida Department of Revenue, Taxpayer Services, MS 3-2000, 5050 West Tennessee Street, Tallahassee, FL 32399-0112.

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