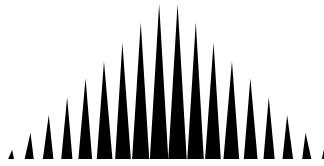


APRIL 2003



T. Dennis Connally Consultant, P.C.
Certified Public Accountant



APRIL 2003

WARNING! WARNING! WARNING!

If your tax returns have not been completed, you need to make sure that a proper extension is filed. Failure to do this will result in you being subjected to a fraud penalty, as not filing your tax return is considered an action of fraud against the Federal Government. Even those of you who owe money but are unable to pay all the tax that is due should file your return on a timely basis either by April 15th or within the extended due date of the extension which is August 15th. This eliminates a late filing penalty, any fraud problems and all you will have is a late payment/interest. Go to my web site: www.tdconnally.com, click on IRS forms and select Form 4868 and you can file this form for yourself. If you prefer our office to file the extension for you, then of course, you will incur charges for us doing that. Our fee is \$75.00 to file this form certified mail and guarantee it is at the IRS on a timely basis. Again, please do not be late in filing your taxes. They are due April 15th but a Form 4868 filed on or before that date gets you an extension until August 15th.



**Regarding S Corporation
Shareholder-Employee**

Before a non-wage employee distribution may be made to a shareholder-employee, an S corporation must pay reasonable compensation (subject to employment taxes) to each share-

holder-employee in return for the services that the employee provides to the corporation. This issue has been identified as an area of noncompliance with the IRS and will receive greater scrutiny in the near future.

Unlike a partnership, flow-through income from an S corporation is not subject to self-employment tax (Revenue Rule 59-221, 1959-1 C.B. 22). In direct contrast, a partnerships' flow-through ordinary income is generally subject to self-employment tax. On the surface, this appears to be a clear tax ad-

vantage of an S corporation versus a partnership. However, in terms of shareholder-employees of an S corporation, the analysis does not end here.

Several court cases support the authority of the Internal Revenue Service to reclassify other forms of payments made to the shareholder-employee as wage expense. For a good example see *Joly versus Comm.* 2000-1 USTC 50315 (6th Cir., 2000). In addition, several court cases have reinforced and clarified the IRS position as to the employee status of S corporation share-

holders who perform services for the S corporation. See Veterinary Surgical Consultants, PC versus Commissioner, 117 T.C. 141 (2001) and Joseph M. Grey Public Accountant, P.C. vs. Commissioner, 119 T.C. No. 5, (September 16, 2002). Provided that an S corporation shareholder is an employee and has received an actual distribution, the only remaining area of

question is what amount is considered "reasonable" for that particular shareholder-employee. All the relevant facts and circumstances are weighed in determining whether the amount paid for the services provided constitutes "reasonable compensation."

Just a reminder that our name has changed! It now is:
T. Dennis Connally
Consultant, P.C.
Certified Public Accountant
Personal Financial Specialist

Our office will be closing on April 15, 2003 at 3:00 p.m. and will be closed on April 18, 2003.

CONGRATULATIONS !!!

We are proud to announce that Donna Cox has passed the Enrolled Agents (EA) test, making her a member of an elite group consisting of only 35,000 active EAs in the United States. There were 7,372 hopefuls who took the grueling exam, which was administered in 91 different locations across the USA. Out of the 7,372, only 2,496 people achieved a passing score, which is a mere 34%.



FYI: EAs are the only taxpayer representatives who receive the right to practice from the United States government. To maintain her status as an EA, Donna will be required to complete 72 hours of continuing education which will keep her up to date on the ever changing tax laws.

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