

Question #7

How Can I Avoid an IRS Hassle Over My Salary?

by Murphy James

“Dear Mr. or Ms. Entrepreneur: Don't pay yourself too much in salary, or you may have the IRS breathing down your neck.” These are the words of New York attorney Arthur H. Rosenbloom, president of Multinational Management Group, whose specialty is defending clients the Internal Revenue Service has hauled into tax court because (the IRS says) they are being overcompensated.

Hey, wait a minute. Can't the entrepreneur enjoy the fruits of his or her labor? What about the inventor of the newest high-tech computer chip, or the CEO who worked for years for peanuts . . . how do they get their just rewards?

Rosenbloom answered such questions recently when *Entrepreneur* interviewed him just hours before he hopped a jet out of New York's JFK Airport for a two-week vacation in Israel.

Entrepreneur: Mr. Rosenbloom, give us a little background about yourself.

Rosenbloom: I'm an attorney and investment banker. I'm the co-author of *Federal Tax Valuation Digest* and

a lecturer at the Wharton School on the subject of mergers and acquisitions. I'm also a specialist in compensation cases and have recently published an article in *Taxes Magazine*, “How to Prove Up an Unreasonable Compensation Case: Methods by Which to Determine Reasonableness.”

Entrepreneur: What do you do in the area of compensation?

Rosenbloom: I deal with both closely held and public corporations that have been challenged by the IRS because one or more persons have taken out of the till what the IRS considers to be an unreasonable amount of money in salary. The IRS' point of view usually is that the company should have been paying that exec a “reasonable” salary plus dividends which are taxable at the shareholder's level. Most of the time I enter the picture after the IRS has already challenged a company. Only in a few cases do I come in as a consultant before a company gets in trouble.

Entrepreneur: Can you cite some other pitfalls in drawing too much salary?



Arthur H. Rosenbloom

Rosenbloom: Oh, sure. There was a case in the news recently where the shareholders of a public corporation sued the company because they thought the CEO was drawing a salary all out of proportion to industry standards and that company's recent performance. Also, companies paying very high salaries and little or no dividends are vulnerable.

Entrepreneur: Can you give us an example of a case that you are working on right now?

Rosenbloom: My firm is currently working on the largest compensation case in history. The situation is this: One of the principals of a small and obviously very successful business took out \$3 million in salary last year. The IRS challenged that.

Entrepreneur: What defense will be put before the IRS?