



LEVERONE & ASSOCIATES, INC.
CERTIFIED PUBLIC ACCOUNTANTS

November 17, 2009

Dear S-Corporation Shareholder,

The Internal Revenue Service (IRS) continues to make our lives easier and easier!! As recently as July 8, 2009, the IRS has issued guidance about S-Corporation shareholders owning more than 2% of the stock and how employee benefits must be treated.

As we have discussed with many of you in the past, as a more than 2% shareholder of an S-Corporation you are treated as an employee of the company and therefore should be "reasonably" compensated for the services you provide to the company. While "reasonable" compensation is not defined in the tax code, the new guidance does note that compensation must be paid to the shareholder employee. Tax courts have supported the IRS's position in this area and have allowed the IRS to reclassify other forms of payments to a shareholder-employee as wages. The significance of this relates to the employment taxes associated with this reclassified wage and the fact that it was not paid timely, and therefore penalties and interest are assessed by the IRS. In addition to this, there are administrative costs of redoing the payroll so the proper W-2's can be issued to the shareholder employee and the corporation. The shareholder tax returns must be amended to reflect these changes, etc. It can become expensive and time consuming to fix.

Unfortunately, as a more than 2% shareholder, the reporting of your employee benefits is different. Health insurance, disability insurance and long term care insurance premiums paid by the corporation on your behalf must be added to the shareholder's W-2 and deducted by the corporation as compensation rather than as an employee benefit. These benefits added to the W-2 are not subject to social security, Medicare, or unemployment taxes. As discussed, the amount is still deductible by the corporation, and not subject to employment taxes, so the actual impact to the shareholder is zero.

Since the impact to the shareholder is negligible and the IRS is "hot" on this issue for auditing taxpayers and their companies, we believe it does not make sense to risk yourself and your company to an IRS audit for an issue with little impact if done properly.

Therefore for 2009, we are encouraging all of our S-Corporation clients to follow this guidance and make sure that employee benefits are included on the shareholders' W-2's. If we prepare your payroll, all you need to do is let us know how much each shareholder's health insurance amount was for 2009 and we will make sure it is reflected properly on the W-2 forms. If you use a payroll service, they will most likely be sending you a letter this month or next to inquire if this adjustment should be considered by the payroll company before they prepare your W-2's for 2009. If they do not contact you, you should contact them regarding this matter. If you would prefer that we contact them, we will be happy to assist, just let us know. If you prepare your own W-2's, you should contact our office for additional guidance.


If you are a more than 2% shareholder but you do NOT provide services to the company, then you are not considered an employee and therefore do not need to have a W-2 issued to you.

If you have a year end tax meeting scheduled with Jack, Bob, or one of our other professionals, we will discuss this issue in greater detail when we meet.

Please call if you have any questions about this or any other matter.

Sincerely,

Leverone & Associates, Inc.


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