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TAX VALUATION E-FLASH

Special Edition

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Normandie Metal Fabricators v. Commissioner, T.C. Memo. 2000-102, March 27, 2000

The following table shows the compensation amounts claimed by the taxpayer, allowed by the IRS, and accepted by the Tax Court:

	<u>1993</u>		
	Taxpayer	IRS	Tax Court
Isodore Klein	\$ 352,000	\$ N/A	\$ 200,000
Steven Klein	\$ 500,400	\$ N/A	\$ 300,000
Total	\$ 852,400	\$ 405,250	\$ 500,000

	<u>1994</u>		
	Taxpayer	IRS	Tax Court
Isodore Klein	\$ 368,000	\$ N/A	\$ 200,000
Steven Klein	\$ 450,400	\$ N/A	\$ 300,000
Total	\$ 818,400	\$ 392,157	\$ 500,000

	<u>1995</u>		
	Taxpayer	IRS	Tax Court
Isodore Klein	\$ -	\$ N/A	\$ -
Steven Klein	\$ 820,400	\$ N/A	\$ 440,000
Total	\$ 820,400	\$ 451,284	\$ 440,000

The Tax Court noted,

In Rapco, Inc. v. Commissioner, 85 F.3d 950, 954 (2d Cir. 1996), affg. T.C. Memo. 1995-128, the U.S. Court of Appeals for the Second Circuit, the court to which an appeal in this case would lie, stated five factors to be considered in assessing the reasonableness of an employee's compensation: (1) The employee's role in the taxpaying company, including the employee's position,



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hours worked, and duties performed; (2) potential conflicts of interest, such as the ability to "disguise" dividends as salary; (3) the employer's compensation policy for all employees; (4) the character and financial condition of the company; and (5) comparison of the employee's salary with those paid by similar companies for similar services. No single factor controls. These factors should be examined from the perspective of an independent investor. See 85 F.3d at 954-955; Dexsil Corp. v. Commissioner, 147 F.3d 96, 100 (2d Cir. 1998), vacating and remanding T.C. Memo 1995-135.

The Tax Court opinion analyzed each of these factors, noting whether the factor favored the IRS or the taxpayer.

The Tax Court upheld an accuracy related penalty for substantial understatement under §6662 in 1993 and 1994, but did not uphold the penalty for 1995. In 1993 and 1994, the taxpayer did not rely on expert advice to arrive at a reasonable salary, but they did in 1995. In addition, the Tax Court noted that the tax returns omitted the "percent of time devoted to business" disclosure for the officers for each of the three years and the Court considered the lack of disclosure "significant".

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