

## Compensation conundrum continues

BY JON B. SPARKMAN AND MAURICE P. GILBERT

After enduring more than five years of intense audit activity, New Hampshire business owners have gained some relief from the Department of Revenue Administration's scrutiny of their compensation deductions.

Relief has come in the form of a revised reasonable compensation statute and, to a lesser extent, through an increase in the amount of the record-keeping safe harbor. These new statutory protections are not a free pass, however, as requirements for New Hampshire business owners cannot be ignored.

The New Hampshire Legislature revised the Business Profits Tax reasonable compensation deduction in 2011 to create a shifting burden of proof in the event of a challenge to an entrepreneur's compensation deduction.

Initially, the taxpayer must prove that each owner of the business organization for whom a compensation deduction is claimed actually rendered personal services during the taxable period. Upon establishing that proof, the burden of proof shifts to the DRA to demonstrate that the amount deducted is clearly unreasonable, an undefined standard.

The revised statute also imposes an obliga-

tion on the business organization to maintain "records as may be necessary to determine that the deduction is reasonable under these standards." This record-keeping requirement is also undefined. No indication is given in the statute, administrative rules or in any information release from the depart-

*Recently enacted  
compensation deduction  
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for business owners*

ment on what records are required or how extensive the records must be.

Regardless, the requirement to keep records is clear. Unfortunately how to comply is not.

### **The harbor and reality**

Recognizing that record-keeping may be burdensome, particularly for smaller businesses, the Legislature added a "record-keeping safe harbor" several years ago.

Conceptually, if the business organization's compensation deduction is less than the safe harbor amount, then the business organization would not have the onus of keeping records to prove the value and extent of the services rendered by the owners.

Initially the "safe" compensation amount was \$50,000 -- for all of the owners of the business and for all of their related businesses. This past session, the Legislature increased this amount to \$75,000. While this safe harbor is welcome for small businesses, in reality, there are likely to be few business organizations that will actually benefit from the safe harbor, given its small dollar amount and narrow scope.

As a result, most business organizations are faced with maintaining records to demonstrate that their owners actually provided services and to establish the value of those services. Accordingly, business owners would do well to take an "ounce of prevention" and discuss their record-keeping obligation with their tax advisers and determine what records they should maintain in order to support the compensation deductions for their services.

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*Jon B. Sparkman, president of the Devine Millimet law firm, is chair of the firm's Tax Practice Group. Maurice P. Gilbert, director of state taxation for the firm, is president of the New Hampshire Society of Accountants.*