

Accounting guidelines for Bonus – S Owner plans

The accounting effects of financial transactions of these plans impact both the company and the stock value in the company. With this bonus plan, the accounting will vary depending on whether an owner uses the compensation (W-2) design or the dividend (K-1) design. However, the net effect of the value of an owner's stock is the same regardless of the design used. The asset is owned by S corporation owner, not by the company, and does not appear on the company's balance sheet.

Here's an example of how the accounting varies between the two designs. It assumes an S corporation owner has an initial basis and is considering how to treat some current profit generated by the business. A dividend (K-1) distribution will also reduce the owner's basis in the S corporation.

Journal transaction example:

[This hypothetical example is for illustrative purposes only.](#)

	Compensation (W-2) design	Dividend (K-1) design
Beginning shareholder basis	\$200,000	\$200,000
Profit	\$20,000	\$20,000
Additional compensation	\$20,000	\$0
Adjusted basis after profit	\$200,000	\$220,000
Dividend paid	\$0	\$20,000
Decrease in basis from dividend	\$0	\$20,000
Ending shareholder basis	\$200,000	\$200,000

Note: This model does not reflect that, because of employment taxes, there might be higher tax costs associated with the compensation (W-2) design than with the dividend (K-1) design. However, if there is more than one owner, dividends distributed need to be in proportion to ownership. If the intended funding is not in proportion to ownership, the compensation (W-2) design should be considered. Also, this does not reflect the deduction that may be available under the Tax Cuts and Jobs Act.

Compensation (W-2) design

If this design is used, the contribution is treated as additional compensation and treated as such in the financial statements.

Payment of base compensation to the S corporation owner ¹	Balance Sheet		Income Statement	
	Debit	Credit	Debit	Credit
Wage expense			\$20,000	
Cash		\$20,000		

Dividend (K-1) design

With this design, the contribution is treated as a distribution with an accompanying reduction in basis. The \$20,000 distribution is a Schedule K-1 item included with Tax Form 1120S. And, because the distribution is to an owner of an S corporation, it reduces the basis in their stock.

¹ The company provides additional compensation of \$20,000 to the owner as a W-2 item and deducts the \$20,000 in the year paid.



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