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I write from D.C. about tax and retirement policy and planning.

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Gingrich Used Payroll Tax Ploy Often Attacked By IRS

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Newt Gingrich avoided tens of thousands of dollars in Medicare payroll taxes in 2010 by using a technique the Internal Revenue Service has consistently and successfully attacked. Republican Presidential candidate Gingrich and his wife, Callista, treated only \$444,327 of what they got from Gingrich Holdings. Inc. and Gingrich Productions as compensation to them, while reporting a whopping \$2.4 million of their earnings from these corporations as profits or dividends. Medicare taxes are levied at a rate of 2.9% on an unlimited amount of compensation and self-employment income (say, from a consulting contract, speeches or a book) but not on profits from a business.

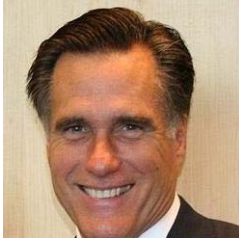
"It appears that he is not paying his fair share of Medicare tax," [Robert E. McKenzie](#), a partner in the Chicago law firm of [Arnstein & Lehr LLP](#) concluded, in an email to Forbes, after reviewing Gingrich's 2010 tax return. McKenzie, a past chairman of the Employment Tax Committee of the American Bar Association Tax Section and a member of the IRS' Advisory Council, added: "There are a multitude of cases where the IRS has

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Forbes Staff[+ Follow on Forbes](#)

I'm the Washington D.C. bureau chief for Forbes and have worked in the bureau for more than two decades. In recent years, I've spent much of my time reporting about taxes -- tax policy, tax planning, edgy tax shelters, tax evasion, wacky tax credits, and

successfully challenged the improper tax strategy of this candidate and his accountants. Service businesses are only allowed to distribute a fair return on investment from an S corp. as profits exempt from Medicare taxes. The remainder of profits must be paid as salary subject to a 2.9% Medicare tax levy.”



If Newt Had His Way, Mitt Would Pay Closer To 0% Tax

Janet Novack
Forbes Staff



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Len Burman
Contributor



IRS Advocate: New Taxpayer Rights Crisis Is Brewing

Janet Novack
Forbes Staff



Since Gingrich released his [2010 tax return](#) Thursday night during the Republican debate, news coverage has focused on his hefty income tax rate—he paid tax equal to 31.5% of his adjusted gross income of \$3.14 million. By contrast, former Massachusetts Gov. Mitt Romney, who earned a fortune at Bain Capital and gets most of his income from investments, acknowledged last week that he pays closer to 15%. (Romney, still smarting from his South Carolina loss Saturday to former House Speaker Gingrich, [said on Fox News this morning](#) that his unreleased returns had become a “distraction” and that he will release his 2010 return on Tuesday.)

The issue of Gingrich’s Medicare tax, however, has started to attract notice from tax pros like McKenzie. The IRS [says on its web site](#) that distributions to an S corp. owner should be treated as compensation to the extent they are associated with his personal services or services to the firm. Earnings that come from an investment of capital and equipment, or from the work of others, can be treated as profit. On his July 2011 financial disclosure form, Gingrich valued his holdings in Gingrich Productions at between \$500,000 and \$1 million, suggesting he has far too little capital invested in the firm to justify booking \$2.4 million as profit. On Gingrich Productions’ [web site](#), there is no suggestion it profits from the work of anyone other than the Gingriches. The site [says](#): “Together, Newt and Callista host and produce historical and public policy documentaries, write books and newsletters, give speeches, record audio books, produce photographic essays, and make television and radio appearances.” (From public filings, it appears that Gingrich Holdings Inc. changed its name to Gingrich Productions last year.)

Neither a Gingrich spokesman nor his accountant returned requests for comment.

President Barack Obama reported all of his \$1.4 million in 2010 book profits as subject to Medicare taxes. Still, Gingrich’s strategy, while frowned upon by the IRS, is hardly unusual. High-earning self-employed individuals have had an incentive to form S corps. and report big profits instead of big wages since 1993, when Congress lifted the cap on the amount of earnings subject to the 2.9% (combined employer and employee) Medicare tax. Back in 1998, when he was a trial lawyer, John Edwards, the former North Carolina Senator and Democratic

Congressional tax malpractice. (Think AMT and the lapsed estate tax.) I also write about retirement policy and planning.

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Janet Novack
Forbes Staff


presidential candidate who is now awaiting trial for alleged campaign violations, [reported a salary](#) of \$360,000 and profits of \$5 million from his S corp. law practice. Congress' Government Accountability Office, [in a report released two years ago](#), estimated that in 2003 and 2004, S corps. underpaid wages to their owners by \$24 billion, skirting payroll taxes on that amount.

The S corp. strategy has no impact on income tax liability. S corps. pay no corporate income tax. Instead, they pass on all their income to their owners' individual returns, where it is taxed at the top individual rate of 35%, the same as for salary. (The corporate dividends paid by C corporations, which do pay corporate tax, are currently taxed at a top individual rate of 15%, so as to minimize the impact of double taxation.)

The temptation for S corp. owners to take too little salary will grow even stronger beginning in 2013, when as part of Obama's new health reform law, couples with compensation exceeding \$250,000 (and singles with more than \$200,000 in compensation) will have to pay an additional 0.9% Medicare surtax on their pay above that amount.

Audits of S corp. compensation issues are time consuming for the IRS. The GAO and some in Congress have looked for easier ways to curb the problem of underreported compensation. In 2010, Senate Finance Committee Chairman Max Baucus (D-MT) [proposed raising \\$11 billion over 10 years](#) by automatically imposing payroll tax on all the distributions to owners of certain "professional service" S Corps. But small business groups and Maine Republican Senator Olympia Snowe, the ranking member of the Senate Small Business and Entrepreneurship Committee, strongly objected and [Baucus dropped the proposal](#).

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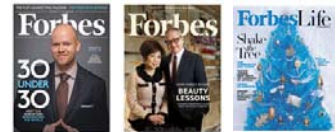
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robertson 1 day ago

When will we see the "have and have more's brought to account. I don't envy their wealth, but why does the system allow them to duck and weave legally?

When the people they are pitching to on a lot less annual income, pay more tax. It causes a division that results in resentment, rather than admiration and aspiration.

Called-out comment

[Reply](#)



solpub 1 day ago

Why does this article use the tenor and tone of the socialist left? I thought i was on the Forbes site. I hope Newt and Mit paid the absolute least amount of protection racket money that they can get away with. I hope Forbes does too. Stop with the "fair share" garbage.

Called-out comment

[Reply](#)



david2012 1 day ago

It's not a matter of his "fair share". It's a matter of his legally required taxes. It was lousy when Edwards did it, and it's lousy when Speaker Gingrich does.

He made \$2,750,000 on his consulting and it was all from his own efforts. He paid payroll taxes on only \$250,000, and pretended that the rest had nothing to do with his efforts, but was corporate profits from something. Except the corporation didn't do or own anything of moment.

Basically, he, like John Edwards before him, cheated on his taxes.

Called-out comment

[Reply](#)**Rick Ungar**, Contributor 1 day ago

Careful solpub- if you actually read articles for content and not just for tenor and tone that you expect to agree with, you might actually learn something!

[Reply](#)**Rick Ungar**, Contributor 1 day ago

Really nice work, Janet!

[Reply](#)**chase51** 1 day ago

Newt and his wife followed the law. If fact I would have, as a CPA in private practice, recommended even less salary and more dividends.

This is used by every S-Corp in America. If you have an S-corp. and are not doing it you are overpaying taxes you could legally, morally, ethically avoid.

The only question is whether Newt and his wife reported earning commensurate with the effort and position they occupied. I think that everyone would agree that over \$440,000.00 of reported income is "reasonable". I would have suggested closer to \$300K myself.

Called-out comment

[Reply](#)**david2012** 1 day ago

Everything that corporation did was due to Speaker Gingrich's efforts. His consulting activities were its entire activities and all its income was his earnings from self-employment. This is an outrageous — if widely used — loophole that is a clear violation of the arm's length requirement of Section 482 with respect to dealings between related parties.

And that is true no matter how many CPAs let their clients get away with it and how many taxpayers try it.

Called-out comment

[Reply](#)**david2012** 23 hours ago

When the corporation has actual capital, when it's engaged in a real business that isn't just personal services, that is an entirely different matter, by the way.

The whole question is what is reasonable compensation as a corporate officer/employee. It is manifestly the case that the corporation here was Speaker Gingrich, that it's activities were his activities, and that nothing it did or owned came close to justifying a corporate profit equal to ten times his compensation.

Called-out comment

[Reply](#)**chase51** 1 day ago

Janet:

Your article is very one sided. Bob Micheals many years ago suggested an 80% reporting requirement. The IRS allows regulaly a 50% rule on smaller companies.

The rules refer to reasonable compensation not all, most, much, half or any specific number just that the salary reported is reasonable.

You do make the point the President Obama was to ignorant to set up an S-Corp for his publishing domain not only forthe tax savings but as a main reason so many incorporate is the liability protection afforded. If the President gets sued over lies in his book he is personally liable instead of having a corporate shield in place.

Called-out comment

[Reply](#)



Peter J Reilly, Contributor 23 hours ago

The cases I have found where the IRS recharacterized distributions were much more egregious. No salary at all or in one case 24,000. I don't think there is a case where S corp distributions have been recharacterized when the shareholder took a salary over the social security max or even one not much below it.

If the IRS were to argue that his salary should have been something like 2.5 million they would be going against a lot of what they have done in reasonable comp cases in C corps.

It is a judgment call. I would have told him to take more of a salary but I cannot prove that his advisers and he were wrong saying 250,000 was enough

[Reply](#)



david2012 22 hours ago

Are you saying that a third party would have paid him \$250,000 or that he would have worked for somebody else for that annual salary?

Because make no mistake, that is what the law requires.

Called-out comment

[Reply](#)



david2012 21 hours ago

Check out the Watson decision (your \$24,000 case), rejecting the taxpayer's motion for summary judgment, which was based on some C corp reasonable compensation decisions:

http://www.iasd.uscourts.gov/index.php?option=com_docman&task=doc_view&gid=1044&tmpl=component&format=raw

The decision quotes that noted socialist, left-wing rabble rouser, Judge Richard Posner:

"The distinction between accounting profits, losses, assets, and liabilities, on the one hand and cash flow on the other is especially important when one is dealing with either a firm undergoing reorganization in bankruptcy or a small privately held firm; in the latter case, in order to avoid double taxation (corporate income tax plus personal income tax on dividends), the company might try to make its profits disappear into officers' salaries. See *Menard, Inc. v. Commissioner*, 560 F.3d 620, 621 (7th Cir. 2009). The owners of a Subchapter S corporation, however, have the opposite incentive – to alchemize salary into earnings. A corporation has to pay employment taxes, such as state unemployment insurance tax and social security tax, on the salaries it pays. A Subchapter S corporation can avoid paying them by recharacterizing salary as a distribution of corporation income."

The Watson court also cited this from *Charles Schneider & Co., Inc. v. Commissioner of Internal Revenue*, 500 F.2d 148, 182 (8th Cir. 1974):

"Several factors to be considered in determining reasonableness of compensation have been mentioned by the courts. Such factors include the employee's qualifications; the nature, extent and scope of the employee's work; the size and complexities of the business; a comparison of salaries paid with the gross income and the net income; the prevailing general economic conditions; comparison of salaries with distributions to stockholders; the prevailing rates of compensation for comparable positions in comparable concerns; the salary policy of the taxpayer as to all employees; and in the case of small corporations with a limited number of officers the amount of compensation paid to the particular employee in previous years."

A first year associate at a top Washington law firm makes \$160,000 before bonuses.

Profits per partner at major Washington law firms are well in excess of \$1 million per year.

Tom Daschle's (a former solon with his own tax peccadillos) reported compensation from Alston & Bird in 2008 was \$2 million as a "special policy advisor."

\$250,000 in salary to Speaker Gingrich from his controlled S corporation is, as I said earlier, simply preposterous. Something closer to Daschle's is the going rate for this particular form of influence peddling.

The Speaker's "tax planning" doesn't come close to passing the straight face test.

Called-out comment

[Reply](#)



joekristan 21 hours ago

Peter, you are correct in saying that it's nowhere near as cut and dried as Gingrich's critics put it (and I don't care for Newt). Until they call out Warren Buffett for not paying enough medicare tax, they don't have any room to call out Gingrich. More at [the Tax Update](#).

Called-out comment

[Reply](#)



david2012 20 hours ago

That is a false comparison. Berkshire Hathaway is a C corporation, so in minimizing Buffett's salary the corporation pays more income taxes. In addition, Buffett does not own all of Berkshire Hathaway. Berkshire Hathaway is not an alter ego of Buffett's, but has real capital and businesses from which it makes its own profits on its own investments and activities.

By vastly understating his compensation from his wholly-owned S corporation, an S corporation essentially all of whose income is attributable to him, the former Speaker costs himself exactly nothing and evades Medicare taxes on his true earning from self-employment.

The two situations aren't comparable at all.

Called-out comment

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