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Owner compensation at year-end:

Balancing taxes and business value



Key takeaways

- Owner compensation decisions can affect more than your tax bill. They may also influence your business cash flow as well as your retirement savings and personal wealth.
- How you pay yourself through salary and distributions depends on your business structure, tax situation and personal financial goals. Changing the mix doesn't necessarily reduce your overall tax liability.
- If you pursue a business valuation, an analyst may adjust earnings to account for differences between your compensation and the market cost of hiring someone to perform your role.
- Reviewing tax implications and potential business value together can help you make year-end compensation decisions that support your current needs and longer-term plans.

As year-end approaches, you may have a clearer picture of your business's performance for the year and what it needs to operate in the months ahead. You may also be considering how you're going to structure your compensation.

The decisions you make about your pay can affect both your taxes and your business's value. The mix of salary and distributions may influence your tax bill, while your total compensation can affect how a potential buyer or valuation professional assesses your business's earnings.

Reviewing both considerations before year-end can help you decide how much to pay yourself while balancing your business's needs with your personal financial goals.

Find the right balance between salary and distributions

Reviewing year-to-date earnings, anticipated expenses and planned investments can help you estimate how much the business can allocate for your pay while meeting its other obligations.

Before finalizing year-end decisions, it's also worth discussing your compensation plans with your tax professional to understand how different payment structures could affect your tax liability.

Generally, business owner compensation comes from a combination of salary and distributions, though the specifics depend on your business structure. Salary typically reflects the work you perform and may be subject to payroll taxes and withholding requirements.

Distributions, on the other hand, are payments to an owner from the business, and their tax treatment varies by entity type and circumstances. Receiving more of your compensation as distributions rather than salary doesn't necessarily reduce your overall tax liability.

The right balance of salary and distributions for your compensation depends on your business's cash needs, its legal and tax structure, and your personal financial priorities. For example, paying yourself more may provide additional cash for household expenses or retirement savings, but it can also leave the business with less money for operating expenses or planned investments.

As you evaluate your compensation strategy, you might ask yourself the following:

- Will the business have enough cash for payroll, operating expenses, taxes and planned investments after you're paid?
- How would a change in salary or distributions affect your overall tax liability, including applicable payroll taxes?
- Will your compensation cover your household expenses, retirement savings and other personal priorities?
- Is your salary reasonable for the work you perform, and are you meeting the tax and payroll requirements for your business structure?

Considering these factors together can help you evaluate your compensation as part of your broader financial plan, rather than focusing solely on minimizing your taxes for the current year.

If you own an S corporation, be ready to support your salary

The IRS generally expects S corporation owners to take reasonable compensation for their duties before taking distributions. You should be prepared to explain how you determined your salary at year-end, so it can be helpful to document your rationale now. Consider factors such as your role and responsibilities, training and experience, time spent working for the business, pay for comparable work at similar businesses, and the company's size and profitability. Your tax professional can also help you assess whether your salary is reasonable.

Keeping your salary low may look appealing as a way to reduce payroll taxes, but that can have longer-term consequences. Social Security benefits are based on covered earnings reported to the Social Security system. If you reduce your wages too aggressively, you may receive less credit towards future retirement, disability or survivor benefits.

For 2026, the Social Security wage base is $184,500. Wages up to this amount are generally subject to the Old-Age, Survivors, and Disability Insurance (OASDI) portion of FICA. Once your wages exceed the base, you no longer pay Social Security tax on additional wages, and those additional wages don't increase your Social Security-covered earnings for that year. Medicare tax, however, doesn't have a wage cap and applies to covered wages above the base limit.[1]

Understand how compensation affects your retirement plan contributions

For S corporation owners, retirement plan contributions are generally based on W-2 wages rather than distributions. A lower salary may limit how much you can contribute to a 401(k) and how much your business can contribute on your behalf. This could reduce your retirement savings and the related tax deductions. Your tax professional or retirement plan advisor can help you weigh these trade-offs against payroll tax savings.

Understand how compensation affects EBITDA

If you're considering a business valuation, potential transaction or long-term succession plan, it's worth understanding how your compensation affects your business's earnings before interest, taxes, depreciation and amortization (EBITDA).

When valuing a business for a potential sale, a valuation analyst may adjust EBITDA to account for differences between the owner's actual compensation and the market cost of hiring someone to perform the same role. These adjustments help estimate normalized earnings, or what the business might earn after accounting for a typical compensation cost for the owner's responsibilities.

If you earn more than it would cost to hire someone else to perform your role, the excess may be added back to EBITDA. If you earn less, the estimated additional compensation cost may be deducted.

For example, if your business pays you $400,000 annually but hiring someone to perform your role would cost $250,000, the $150,000 difference could be added back when calculating normalized earnings, depending on the circumstances.

These adjustments can affect how a potential buyer evaluates your business's earnings and estimated value. However, owner compensation is only one factor in a valuation, which also considers the business's financial performance, operations and the valuation method used.

If a future sale or succession is part of your plans, reviewing how your compensation compares with market rates can help you anticipate questions about normalized earnings during the valuation process.

Coordinate tax planning and valuation considerations

Tax planning and business valuation are often handled separately, but year-end is an opportunity to consider how compensation decisions may affect both.

Start by discussing proposed changes to your salary or distributions with a tax professional, including their implications for your business tax liability and cash flow. If you're considering a future sale or succession, Mariner's investment banking team may be another resource to consult as you evaluate how owner compensation compares with market rates and may affect normalized earnings.

These conversations can help you evaluate the trade-offs before you decide how to proceed. For example, you may need to balance the value of retaining cash for business growth against the need to fund personal savings or retirement goals. Considering both your business's needs and your household's financial priorities can help you determine what makes sense for your circumstances.

Make year-end decisions with the bigger picture in mind

Owner compensation decisions connect your business's financial needs with your personal financial goals. Reviewing the tax implications, potential valuation impact and resources available to you outside the business can help you make decisions that support your longer-term plans.

Your advisor can work with you, coordinating with your tax and valuation professionals as needed, to help assess how your business income and compensation fit into your broader financial picture.

For more information visit: **mariner.com**

[1]IRS. Social Security and Medicare withholding rates. 2026

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