

DETERMINING REASONABLE COMPENSATION

The Cost Approach

The Cost approach (AKA Many Hats Approach) takes into consideration all the tasks a business owner provides to their company. The Cost approach breaks the time spent by the owner down into the various tasks performed; wage levels are assigned for each task based on the owner's proficiency; and then added back together to obtain a hypothetical replacement cost for the owner.



Best option for determining reasonable compensation for a small business owner



Relies solely on comparability data.

Step by step best practices for determining Reasonable Compensation using the Cost approach

#1

List all of the services the business owner provides to their company. Don't leave any out even if they are not income producing.

#2

Estimate the amount of time devoted to the business and break it down by each service listed in Step One.

#3

Do the math. Multiply the time spent on each service by the wage. Then tally everything up.

You have now calculated what the IRS and Courts call the business owners "Replacement Cost" or "Fair Market Value" or what Valuation experts call the "Hypothetical Replacement Cost of an owner or key manager of a business."

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