

AUDIT-PROOF YOUR S-CORP

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Why S-Corps Get Flagged

You formed your S-Corp to save on taxes, build credibility, and protect your income.

Smart move. 

But here's what most business owners don't realize:

The **same election that unlocks tax savings also puts you under a sharper microscope.**

The IRS *loves* S Corporations—for audits.

Not because they're shady, but because they're commonly misunderstood. And misunderstandings =

easy audit targets.

Let's unpack why.

S-Corp = More Savings, More Scrutiny

The IRS knows that S Corps allow business owners to split income between:

- A **salary** (which gets taxed for Social Security and Medicare)
- And **distributions** (which don't)

That's where the savings happen—and where abuse can start.

So the IRS has one big question: “**Are you paying yourself a reasonable salary?**”

If the answer isn't clearly documented—or looks suspicious—they take a closer look.

But salary isn't the only issue...

The Most Common S-Corp Audit Triggers Include:

- Paying **too little salary** (to dodge employment tax)
- Reimbursing yourself without an **Accountable Plan**
- Deducting personal expenses as business costs
- Missing or sloppy **1099 and W-2 filings**
- Forgetting to file **Form 1120-S** on time
- Taking **distributions before payroll**
- Using a business card for **non-business spending**

The scary part?

You might be doing one or two of these things *without even knowing they're audit risks*.

But don't worry—we're going to fix that. And it's easier than you think.

What This Bonus Will Help You Do:

In the pages ahead, you'll learn:

- How to avoid every major audit trigger
- The right way to set up reimbursements, salary, and records
- The simple “audit shield” moves that protect legit businesses like yours

You don't need to fear the IRS.

You just need to stop giving them easy reasons to dig deeper.

Let's start by looking at exactly what the IRS *looks for* when it scans your S-Corp return...

The IRS Audit Playbook (What They Look For)

Think of an IRS audit like airport security.

Most people pass through without a second glance.

But if something looks off—too much liquid in your bag, a weird item on the scanner, or you "fit a profile"—they stop you for a closer look.

👉 That's exactly how S-Corp audits work.

The IRS uses **filters, flags, and formulas** to identify returns that *look* risky—so they can focus limited audit resources on returns most likely to yield results.

Let's break down what puts your S-Corp return on their radar 📌

🔍 1. The Salary-to-Distribution Ratio

This is *the* biggest audit trigger for S Corporations.

Why? Because the S-Corp structure allows you to:

- Pay yourself a **W-2 salary** (taxed normally)
- Take the rest as **distributions** (no self-employment tax)

And the IRS *knows* most people want to minimize taxes.

So they look for:

- **Low or no salary** paired with
- **High distributions**

📊 Example Red Flag:

You earned \$100,000 net income

→ Paid yourself a \$10,000 salary

→ Took \$90,000 in distributions

🧠 That's a big "audit me" signal. The IRS expects a **reasonable wage** based on your role, industry, and business profit.

We'll cover how to set that salary the right way in the next section.

🔍 2. Large or Frequent Reimbursements

Reimbursing yourself for business expenses isn't the problem.

Doing it *without documentation* or a compliant **Accountable Plan** is.

Things that raise flags:

- Home office reimbursements with no written policy
- Mileage logs that look made up
- Random lump-sum payments labeled "reimbursement"
- Using personal accounts to pay business expenses, then reimbursing yourself later

🧠 If your books don't clearly show what was spent, when, and for what purpose—the IRS assumes it's **personal**.

🔍 3. Personal Expenses Masquerading as Business Deductions

This one's a classic.

Examples the IRS loves to dig into:

- Clothing (unless it's branded and only used for work)
- Meals (especially with no names or purpose listed)
- Travel (that's really vacation)
- Tech (laptops, phones, tablets) that aren't used *primarily* for business
- Vehicle deductions with no mileage log

🧠 If your lifestyle is flowing through your S-Corp—but your documentation is weak—you're at risk.

🔍 4. Missing or Late Filings

S-Corps come with obligations:

- File **Form 1120-S** on time (March 15 or extension)
- Issue **W-2s** to yourself (as an employee)
- Send **1099-NECs** to contractors you paid \$600+
- File payroll tax forms quarterly (Form 941, etc.)

Late, missing, or inconsistent filings = audit bait.

Especially if you're paying yourself but not running **payroll**.

🔍 5. Prior-Year Adjustments or “Outliers”

Things that cause the IRS to pause:

- Huge change in income or deductions
- Claiming new deductions without clear justification
- Amendments that shift large amounts of income
- High ratios of deductions to revenue

🧠 Any big swing from the norm—especially if it benefits you tax-wise—should be backed by solid records.

🎯 Bottom Line:

If your S-Corp return includes:

- ✓ A reasonable salary
- ✓ Clean, documented reimbursements
- ✓ Clear separation of personal and business expenses
- ✓ On-time filings with proper payroll...

You'll likely *never* hear from the IRS.

In the next section, we'll dive into the most common—and most fixable—red flag of them all:

👉 How to choose (and justify) a **reasonable salary** that keeps you safe *and* saves you money.

💰 Payroll Red Flags: The “Reasonable Salary” Rule

This one is big.

If you're an S-Corp owner actively working in the business, the IRS expects you to pay yourself a **reasonable salary** before taking any distributions.

Why?

Because they want their cut of **payroll taxes** (Social Security + Medicare), which only apply to W-2 wages—not to owner draws.

And they're watching.

🔍 What Triggers the IRS?

The biggest red flag is this:

Taking large distributions while paying yourself little (or nothing) in wages.

🧠 Translation:

If you're running a profitable business and paying yourself \$10K/year in W-2 wages, but taking \$90K in distributions... the IRS is *definitely* interested.

They've even won court cases where business owners tried to skate by on low salaries to avoid payroll tax.

✅ What Counts as a “Reasonable Salary”?

There's no magic number—but the IRS does look at:

- What someone in your role would earn on the open market
- Your duties, responsibilities, and time spent in the business
- Your business's profitability
- Industry norms and regional averages
- Whether you're the only person generating income

📊 Example Benchmarks:

- A freelance graphic designer might reasonably pay themselves \$40K–\$60K
- A tech consultant bringing in \$250K solo? \$80K–\$120K might be more appropriate
- A part-time business owner with \$30K in net profit? A \$15K–\$20K salary could be fair

🧠 The IRS isn't trying to punish you—they're just looking for numbers that make sense.

📊 Salary vs. Distribution: A Smart Split

Let's say your S-Corp nets **\$100,000** after expenses.

A smart, audit-safe split might be:

- \$50,000 W-2 salary
- \$50,000 distribution (which avoids self-employment tax)

💡 This setup gives you:

- ✓ Compliance
- ✓ Payroll tax savings
- ✓ Peace of mind

📁 How to Run Payroll

If you've elected S-Corp status, you *must* run legit payroll.

Here's what that includes:

- Use payroll software (like Gusto, QuickBooks Payroll, or ADP)
- Withhold and remit federal/state taxes
- File quarterly and year-end payroll forms (941s, W-2s, etc.)
- Cut yourself a check on a regular schedule (monthly or bi-weekly is common)

⚠️ Don't DIY this part unless you *really* know what you're doing. Software or a payroll provider is well worth it.

🧠 Pro Tip: Set It. Forget It.

Pick a fair salary, automate your payroll, and focus on growing your business.

The IRS doesn't audit people who:

- Pay themselves consistently
- Keep payroll records
- Avoid suspiciously low salaries

🎯 Bottom Line:

Paying yourself a "reasonable salary" is the **cornerstone** of audit-proofing your S-Corp.

It's not just about tax savings—it's about protecting your business and showing the IRS you're doing things the right way.

Next up, we'll cover another sneaky audit magnet: **reimbursements**.

📄 Reimbursement Mistakes That Attract Audits

You've probably done it.

Bought office supplies with your personal card...

Filled up your gas tank on the way to a client meeting...

Paid out-of-pocket for a business lunch...

Then later reimbursed yourself from the business account.

Totally normal, right?

✔ Yes—if you do it the **right** way.

✘ But if you're reimbursing yourself *without documentation or structure*, the IRS sees a big red flag.

Let's break down why, and how to fix it.

⚠ The Problem: Personal Reimbursements Without a Plan

S-Corp owners often reimburse themselves for:

- Home office expenses
- Mileage
- Internet or phone usage
- Travel and meals
- Supplies or software bought with a personal card

And that's fine—if **you have an Accountable Plan** in place.

Without it, the IRS can reclassify those reimbursements as:

- **Distributions** (not deductible), or worse...
- **Wages** (triggering retroactive payroll taxes + penalties)

🔴 That's an expensive fix—especially if they audit multiple years.

✔ The Solution: Set Up an Accountable Plan

An **Accountable Plan** is an IRS-approved system that lets you:

1. Reimburse yourself for legit business expenses
2. **Deduct those expenses** on the business return
3. Avoid triggering extra taxes

It's like a firewall between:

- What the business owes you
- And what the IRS considers personal benefit

🧠 Think of it as your official "rules of engagement" for getting paid back.

🔧 What Your Accountable Plan Needs

Setting one up is easy—and it's one of the best audit-proofing moves you can make.

Here's what to include:

1.  **A Written Policy**
 - Explains how and when employees (including you) get reimbursed
 - States that all expenses must have receipts and a clear business purpose
 - Includes a time frame (typically 30–60 days) for submitting expenses
2.  **Documentation for Every Reimbursement**
 - Receipts or mileage logs
 - Date, amount, and purpose
 - Proof it was a business-related expense
3.  **A Reimbursement Workflow**
 - Submit expense report
 - Business reimburses from the biz account
 - Clean paper trail = IRS approved

 Bonus: You can use a simple spreadsheet template or bookkeeping app like Expensify, QuickBooks, or even Google Sheets to track this.

What You Can Reimburse (With an Accountable Plan)

Here are some common, **fully deductible** expenses you can reimburse through your S-Corp (assuming proper documentation):

-  Business mileage (standard IRS rate)
-  Home office use (portion of rent, utilities, internet)
-  Business meals (50% deductible)
-  Travel expenses
-  Cell phone/internet (business portion)
-  Software subscriptions
-  Supplies paid for personally

 Reminder: Without a plan, these aren't deductible by the S-Corp. With one, they are.

 Bottom Line:

If you're reimbursing yourself *without an Accountable Plan*, you're asking for trouble.

- ✓ Create a simple, written policy
- ✓ Track everything with receipts and purpose
- ✓ Reimburse yourself consistently and on time

Coming up next:

We'll look at how business owners accidentally blend personal and business spending—setting themselves up for scrutiny without realizing it.

Avoiding “Corporate Card Creep”

You start with good intentions.

You open a business bank account.

You get a corporate debit or credit card.

You promise to *only* use it for business.

But then...

 You grab lunch and forget to separate the personal item.

 You swipe it at Target for "business supplies" (and also groceries).

 You book a flight that's *kind of* for work... but also vacation.

Over time, you start blurring the lines—and that's what we call **corporate card creep**.

! Why It Matters to the IRS

If you use your business account for personal spending, here's what the IRS assumes:

1. **Your books aren't clean**
2. **You're not running a real business structure**
3. **You're masking personal expenses as deductions**

None of those are good.

Worse?

If you're audited and they find **commingling of funds**, they can:

- Deny deductions
- Reclassify reimbursements as income
- Disqualify your S-Corp election in extreme cases
- **Pierce your corporate veil** in legal matters

That means *less tax savings, more liability*, and a whole lot of hassle.

How to Keep Personal & Business Separate (For Real)

Here's how to draw a crystal-clear line the IRS will respect:

Use a Dedicated Business Account—Only

- Pay all business expenses from a business checking account
- Deposit all revenue into that account
- Don't use it for personal spending—even "just this once"
- Don't pay personal credit cards or subscriptions from it

 Tip: Use a personal credit card for everything non-business. No exceptions.

Don't Pay for Business with Personal Cards (Unless Reimbursed)

If you accidentally use a personal card for a business expense:

- Reimburse yourself through your **Accountable Plan**
- Document it like any other expense
- Never just “eat the cost” and deduct it anyway

✔ Keep a Clean Paper Trail

- Save receipts (digitally or in folders)
- Note business purpose for meals, travel, etc.
- Don't use vague categories like “miscellaneous”

🧠 The IRS doesn't care if you *meant* to do it right. They care what your records say.

✔ Use Bookkeeping Tools That Flag Personal Activity

Apps like QuickBooks, Bench, or Xero make it easy to:

- Categorize expenses
- Reconcile transactions
- Spot anything unusual (like your Friday night Uber ride)

💡 Bonus: These tools help your tax pro prep faster—and back you up in case of questions.

🎯 Bottom Line:

The easiest way to protect your S-Corp?
Treat it like the separate business it *legally* is.

Keep your business card clean.
Keep your personal life off your books.
And you'll keep auditors moving right past your return.

Next up:

Let's talk about documentation—because **what you keep (and how you keep it)** matters more than most business owners realize.

Documentation That Defends You

If the IRS ever audits your S-Corp, you'll need more than good intentions.
You'll need **receipts, records, reports—and a paper trail that backs up every move.**

Here's the good news:
You don't need fancy systems, expensive software, or a degree in accounting.

Just consistency, clarity, and a few smart habits.

What to Keep (and Why)

Here's what the IRS will ask for in an audit—and what you should already have on file:

Item	Why It Matters
Receipts for expenses	Proves the purchase was business-related and legitimate
Mileage logs	Supports vehicle deductions (standard or actual)
Payroll reports	Confirms salary, withholdings, and tax filings
Bank and credit card statements	Helps verify clean separation of business and personal
Reimbursement records	Shows Accountable Plan compliance
Tax returns (past 3 years)	Baseline for what you reported and how it matches your books
Form 2553 (S Corp Election)	Confirms your status with the IRS
1099s and W-2s	Verifies you're treating contractors and employees correctly
Operating Agreement / Bylaws	Shows you've structured your business properly

🧠 If it touches money, taxes, or your legal setup—**save it**.

📁 How Long to Keep Records

- **3 years** for most tax-related documentation
- **6 years** if you underreported income by more than 25% (intentional or not)
- **Indefinitely** for formation docs, EINs, S Corp election forms, and legal agreements

💡 Tip: Go digital. Use cloud storage (Google Drive, Dropbox, Evernote) with labeled folders by year and category. You'll thank yourself later.

🧠 What About Spreadsheets?

Spreadsheets are fine—if they link back to real receipts.

A mileage log in Excel? ✅

A list of meals with dates and purposes? ✅

A “marketing” tab with no receipts, vendors, or notes? ❌

Pro tip: Always include **who, what, where, when, and why**.
Those five little details make all the difference during a review.

Tools That Make This Easy

You don't need to become a bookkeeper—you just need the right helpers:

- **QuickBooks Online** – Tracks income/expenses, links to bank accounts
- **Expensify** – Great for scanning receipts and mileage tracking
- **Gusto** – Handles payroll, W-2s, tax filings
- **Google Drive or Dropbox** – Digital filing cabinet for docs
- **MileIQ or Everlance** – Mileage tracking apps that auto-log your drives

 If it makes tracking easier, use it. The IRS won't give you extra credit—but your accountant will.

 Bottom Line:

Documentation is your audit armor.

It's not just about being organized—it's about being protected.

- ✓ If your numbers are clean
- ✓ Your records match your returns
- ✓ And every deduction has backup...

You can handle anything the IRS throws your way—with confidence.

Up next:

Let's bring all this together with a proactive strategy to keep your S-Corp audit-resistant, year after year.

The Proactive Audit Strategy

Avoiding an audit doesn't come from playing small or flying under the radar.

It comes from **playing smart**.

S-Corps that operate cleanly, document properly, and follow a repeatable system rarely get audited—and when they do, they're ready.

This section is your blueprint for making *that* your reality.

Make Audit-Proofing Part of Your Monthly Routine

Just like brushing your teeth or checking your bank balance—**audit-proofing is a habit**, not a one-time event.

Here's a simple monthly workflow to keep your S-Corp airtight:

- ✓ Monthly Audit-Proof Checklist

- Run payroll (via Gusto, QuickBooks, or your provider)
- Record and reimburse business expenses (with receipts)
- Reconcile your business bank account
- Update mileage logs, home office use, or travel records
- Review your profit distribution ratio (is your salary still reasonable?)
- Scan and save receipts into cloud storage
- Separate and flag any personal spending (and fix it immediately)

🧠 Tip: Block 60–90 minutes on your calendar at month-end. Turn on a podcast, sip a coffee, and run your “S-Corp Health Check.”

📊 Use Reports to Spot Issues Before the IRS Does

Every quarter or so, generate these reports from your bookkeeping or payroll software:

- **Profit & Loss Statement (P&L)** – Shows income, expenses, and owner draws
- **Balance Sheet** – Reveals any liabilities or retained earnings building up
- **Payroll Summary** – Confirms you’re consistent with salary and withholdings
- **Expense Detail Report** – Makes it easy to scan for personal expenses hiding as business

If *you* can clearly see the story these reports are telling...

So can your tax pro—and the IRS (if it ever comes to that).

🧑‍💻 Have a Tax Pro on Your Team

This isn’t a DIY game.

Even with clean books and best practices, you want a CPA or EA who:

- Understands S-Corp nuances
- Reviews your salary + strategy annually
- Files your 1120-S and ensures compliance
- Can represent you if anything ever comes up

🧠 Think of them as your “audit bodyguard.”

You’re smart enough to stay out of trouble—but it’s nice to have backup.

💬 Keep Notes for Anything Weird

Sometimes your financial year includes:

- Unusual travel
- Big equipment purchases
- Massive one-time projects
- Revenue dips or jumps

- COVID-related adjustments

 Keep a short “What Happened This Year” document.
List anything outside the norm, just in case the IRS asks later.

 Bottom Line:

You don't need to be afraid of an audit.
You just need to stop **accidentally inviting one**.

When your systems are simple, your records are clean, and your strategy is intentional...

You're audit-proof in the eyes of the IRS—and unshakable as a business owner.

 In the final section, we'll give you a complete checklist to lock it all in.

Audit-Proofing Checklist

One List. All the Moves. No Guesswork.

Use this checklist monthly, quarterly, or whenever you want to feel *rock-solid* about your S-Corp compliance. Check every box—and you're operating like a pro.

Payroll & Compensation

- Pay yourself a **reasonable salary** based on your role and profit
- Run payroll through software (Gusto, QuickBooks, etc.)
- File all required payroll forms (941s, W-2s, 940s) on time
- Avoid taking distributions *before* you've paid a salary

Business Expenses & Reimbursements

- Set up an **Accountable Plan** for all owner reimbursements
- Keep receipts + document the **who, what, when, where, and why**
- Reimburse within 30–60 days
- Never run personal expenses through the business account
- Separate business + personal bank accounts—no exceptions

Recordkeeping

- Use bookkeeping software to track income, expenses, and payroll
- Save all receipts, logs, and reports in cloud storage (Google Drive, Dropbox, etc.)
- Keep mileage logs and home office records up to date
- Retain tax docs, 2553 forms, W-2s, and 1099s for at least 3 years (or more)

Ongoing Compliance

- ❑ File 1120-S on time (March 15 or file an extension)
- ❑ Issue W-2s for owner-employees and 1099s for contractors
- ❑ Review reports (P&L, balance sheet, payroll summary) quarterly
- ❑ Meet with a tax pro annually to reassess strategy and salary
- ❑ Document any major one-off events (“What Happened This Year” note)

🎯 Nail this checklist, and you’ll be:

- ✅ Legally compliant
- ✅ IRS audit-resistant
- ✅ Financially dialed in
- ✅ Focused on growth—not scrambling at tax time

🙏 Enjoyed this bonus?

If this helped you feel more confident, protected, and in control of your S-Corp strategy, the best way to say thanks is to **leave a quick review for the book**.

Your feedback helps other business owners find this resource—and helps us continue creating high-impact content like this.

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Thanks for being part of the smart-business-owner club. 🙌