

Tax aspects of corporate directorships

If you serve on the board of directors of one or more corporations, there are a number of tax rules of which you should be aware. In your role as a corporate director, you are considered to be an independent contractor, not an employee of the corporation. This fact has several important tax consequences, including the following:

Directors' income and deductions. The fees that you receive as a corporate director are subject to current income taxation. However, because you are considered to be in the "business" of serving as a corporate director, you can deduct your ordinary and necessary expenses of carrying on this business. For example, you can deduct away-from-home travel expenses that relate to your duties as a director.

These are business expenses and not itemized deductions, so they aren't subject to any limitations based on your income. However, if you are also an investor in the corporation, your expenses may be treated as investment expenses rather than business expenses. In that case, they will be miscellaneous itemized deductions, and will only be deductible to the extent that they exceed 2% of your adjusted gross income.

Keogh retirement plans. You may be able to postpone paying tax on your directors' fee income by making deductible contributions to a pension or profit-sharing plan for self-employed individuals known as a Keogh plan. Deductible contributions of up to 20% of this income—up to a maximum of \$46,000, in 2008—may be made to these types of Keogh plans.

Your participation in a Keogh plan would be in *addition* to any qualified pension and profit-sharing plan in which you already participate as an employee. Participation in an employee plan wouldn't limit the amount you could contribute and deduct under a Keogh plan.

Self-employment tax. As an independent contractor, you will be subject to self-employment tax on your directors' fee income. Self-employment tax is imposed in addition to income tax, but you can deduct half of your self-employment tax as an adjustment to income.

Self-employment tax consists of a Social Security portion and a Medicare portion. The Social Security tax is imposed at 12.4%, but only on self-employment income up to a certain amount. For 2008, it applies to the first \$102,000 of self-employment income. However, if you have salary income of at least \$102,000, you won't be liable for Social Security tax on your directors' fees. The Medicare tax is imposed at 2.9% on all of your self-employment income, whether or not you also have salary income.

Trust fund penalty. Corporate directors should bear in mind their potential exposure to liability for the trust fund recovery penalty. "Trust fund" taxes include withheld income tax and Social Security tax that the corporation deducts from employees' wages and pays over to the government. When these taxes aren't properly collected and paid over, the persons responsible for collection and payment are liable for 100% of the shortfall. Obviously, the amount of this penalty can add up very quickly.

There's no rule that automatically makes corporate directors liable for the trust fund penalty if taxes aren't paid. Rather, the critical issue is who had the authority and the duty to see to it that the trust fund taxes were paid. However, there have been cases in which directors were held liable for the penalty, so this possibility shouldn't be ignored.