

Owners of a Corporation Pay the Corporation's Expenses; Can Such Expenses be Deducted by the Owners?

Alert

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As a general rule, a corporation is considered a separate entity from its owner(s). There are a few cases in which a corporate entity is disregarded as an entity separate from its owners, such as when a corporation is set up and treated as an agent of the stockholders as a workaround state usury laws that restrict interest rates that can be charged but do not apply to corporations, *Roccaforte v. Comm'r*, 77 TC 263 (1981), *rev'd*, 708 F. 2d. 986 (5th Cir. 1983) (reversed due to Court of Appeals' determination that the corporate agent's relationship with its principal must not be dependent upon the ownership by the principal).

In most settings, a stockholder cannot deduct expenses owed by a corporation of the stockholder's own creation. The decisions in this area arose before S corporations even existed and the result is easier to understand when a regular tax paying corporation (C corporation) is the entity that the owner(s) attempt to ignore after forming such an entity that is treated entirely separate from its owners for federal income tax purposes. A recent U.S. Tax Court case found the owners of an S corporation are subject to this same general rule when they individually paid obligations of the S corporation (real estate taxes and operating expenses) from personal funds and attempted to deduct the expenses on their personal income tax returns. While the expenses were business expenses, it was the business of the corporation not of the owners. See *Vorreger, et. al., v. Comm'r*, T.C. Memo 2022-97 (September 21, 2022).

There are some exceptions to the general rule that might be applicable to other situations:

- The owner is involved in the same business as the corporation to such an extent that the payment of the expense is ordinary and necessary to the business of the owner and the corporation is financially unable

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to pay the expense (*Lohrke v. Comm'r*, 48 TC 679 (1967)).

- The expense paid by the owner is allowed as an expense on the return of the corporation, even though paid for by the owner (*Ferguson v. Comm'r*, TC Memo 2019-40) or the payment of an owner's expense by the corporation that is charged to the owner on the books of the corporation can be deducted by the owner (*Goodman v. Comm'r*, 5 T.C.M. 1126 (1946) (Docket No. 103137, Issue D)) but these decisions are frequently challenged by the IRS.
- By statute, a corporation can pay a tax imposed on an owner's interest in the corporation (such as a property tax on the stock of the corporation) and deduct the payment at the corporate level and not seek reimbursement from the owner (See IRC § 164(e) and Treas. Reg. § 1.164-7). However, such taxes are increasingly rare.
- There is some authority for a trust beneficiary to pay and deduct real estate taxes imposed on the trust as the title holder of the real estate, on the theory that the beneficiary is the beneficial owner of the property (*Movius*, 22 TCM 391 (1954); *Ligget*, 4 TMC 598 (1945)).

Returning to the S corporation scenario, it is far safer to do a two-step procedure that often gets to the same result: have the owner(s) loan or contribute funds to the corporation and then have the corporation pay the expenses due, allocating the expenses paid to the owner(s) as part of the pro rata share requirements of IRC § 1366(a). The recent Tax Court case cited at the outset, *Vorreger v. Comm'r*, rejected an argument that an S corporation's trade or business should be attributed to the owners and allow the expenses paid by the owners to be deducted on personal returns, citing a previous Tax Court case, *Russell v. Comm'r*, TC Memo 1989-207 (1989), in respecting the existence of an S corporation in the same manner as a C corporation.

As S corporation expenses come due, think about using the two-step procedure discussed in the prior paragraph as the preferred solution to having the owners pay the expenses and attempting to deduct such expenses directly rather than having them passed through from the S corporation.

For C corporation owners, the two-step procedure is not available and unless the *Lohrke* exception discussed in the first bullet above is available, the better procedure is to cause the corporation to have sufficient funds to pay the expense and add to the corporation's net operating loss and hope that such loss can eventually be utilized. This is particularly true through 2025 since unreimbursed expenses of an individual employee are not deductible as itemized deductions.

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