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IRS acquiescence, loans to S corporation not wages

The IRS announced its acquiescence “in result only” to a 2016 memorandum opinion of the U.S. Tax Court whether an S corporation’s payments of personal expenses on behalf of its sole shareholder-corporate officer constituted wages subject to federal employment taxes or the repayment of shareholder loans to the S corporation.

Read text of the Action on Decision 2017–04 that appears in the April 10, 2017 edition of the **Internal Revenue Bulletin 2017-15** [PDF 1.1 MB].

Summary

The taxpayer is an S corporation. The individual was the sole shareholder and president of the taxpayer, and served as the sole corporate officer. The individual worked full time for the taxpayer. In order to fund the business’ growth, the individual began raising money for the taxpayer from various sources (including advances and loans from family members and lines of credit). The taxpayer was initially profitable, but experienced a decline in business in 2008.

Before the court were two issues: (1) whether the individual must be classified as an employee of the taxpayer for employment tax purposes; and (2) whether the taxpayer’s payment of personal expenses on behalf of the individual must be characterized as wages subject to federal employment taxes.

In order to address the two issues before the court, the court had to determine the proper characterization of the transfers by the individual and his family to the taxpayer as either loans or capital contributions by consideration of all the evidence before the court. The court indicated that although many factors are considered in determining whether funds transferred to a closely held corporation are loans or capital contributions, “the ultimate question is whether there was a genuine intention to create a debt, with a reasonable expectation of repayment, and whether that intention comported with the economic reality of creating a debtor-creditor relationship.”

The court held that the evidence demonstrated the individual's intention to create a debtor-creditor relationship with the taxpayer: The taxpayer reported the advances from the individual, etc. as loans on its books and tax returns; the taxpayer consistently reported the personal expenses it was paying on behalf of the individual as repayment of the loans and were consistently paid regardless of the value of service the individual provided to the taxpayer; and most importantly, the taxpayer made repayments when the taxpayer was operating at a loss.

The court also held that the individual had a reasonable expectation of repayment of the funds provided to the taxpayer during 2006 – 2008, because the taxpayer was operating profitably and showed signs of growth. However, the court concluded that it did not find a similarly reasonable expectation of repayment existed for advances after 2008, because the taxpayer's business dropped off sharply resulting in less likely of consistent repayments; and the taxpayer's and the individual's inability to raise funds from unrelated third parties.

The court held that the taxpayer had a sufficient outstanding loan balance to the individual at the time the repayments were made such that the loan repayments made during the years at issue did in fact constitute loan repayments. As a result, the individual's personal expenses paid by the taxpayer were considered repayment of debt and not wages to the individual.

The case is: *Scott Singer Installations, Inc. v. Commissioner*, T.C. Memo 2016–161. Read the U.S. Tax Court's **decision** [PDF 73 KB]