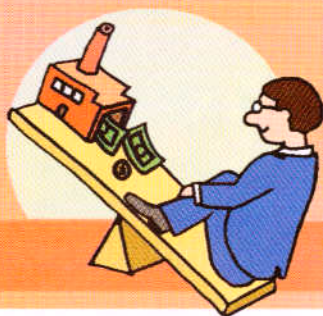


Make the Most of A Loan From Your Company

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Business owners may find themselves short of cash while the company has ample liquid reserves. If that's the case, it might be tempting to borrow money from the business.

Such tactics may make sense, especially if the alternatives are taking a bank loan or running a credit card balance. *But proceed cautiously to avoid tax traps and other dangers...*

defend against dividends

Avoid simply transferring funds from the company's bank account to your own, making a mental note that this is a loan.

Trap: If the IRS examines your personal or business records, the transfer might be considered a dividend.

Result: The entire amount could be taxable income to you. A \$50,000 "loan," for example, could add \$50,000 to your income for the year.

Moreover, dividends are not deductible for the company. If you run your business as a regular C corporation, the amount of the transfer could be subject to both personal and corporate income tax.

Strategy: Any loan between a company and an employee (especially if the employee is a shareholder) should be formalized.

The loan document should state an interest rate, repayment terms, and procedures to be followed in case of default. If you're the borrower, adhere to the terms of the loan.

Added protection: To defend against a possible future charge

that the transfer was a dividend, record the loan in your corporate minutes. Make a note to the effect that a loan is being made to a corporate executive to relieve personal financial pressures and thus facilitate performance of business-related responsibilities.

A loan will look more realistic if some interest is charged, even at a below-market rate, and if that interest is paid on schedule.

lack of interest

As mentioned, a company-to-shareholder loan will be on safest ground if interest is charged and paid. For the best tax outcomes, such interest will be at a market rate—it will be treated as a loan rather than a taxable gift or dividend.

However, you might prefer to pay a below-market rate of interest, or no interest at all.

Tax treatment: With few exceptions (see next page), interest in such cases will be imputed by the IRS on loans between employers and employees.

Example: Walt Smith is the 100% owner of ABC, Inc. He borrows \$50,000 from the company, interest free. At the time of the transaction,

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