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# Business Owners—Taking Money Out of a Business


Sprague & Jackson
ACCOUNTANTS AND ENROLLED AGENTS
The Seneca Building • 121 E Seneca St • Ithaca, NY 14850

David W. Sprague, EA, ABA Principal
Angie Jackson, EA, MSA Principal

Phone: (607) 273-5322
Fax: (607) 273-8138
Email: Admin@sprjac.com


## Business Owners— Taking Money Out of a Business

When taking money out of a business, transactions must be carefully structured to avoid unwanted tax consequences or damage to the business entity. Business owners should follow the advice of a tax professional to make sure financial transactions are controlled and do not cause unanticipated taxation or other negative effects.

For example, a shareholder of a corporation can make a loan to the corporation, and subsequent repayments of principal are not taxable to the shareholder. This may seem straightforward. However, if the loan and repayments are not set up and processed properly, with specific documentation in place, the IRS can reclassify the funding as nondeductible capital contributions and classify the repayments as taxable dividends, resulting in unexpected taxation. A weak loan structure can also create a danger zone where a court can "pierce the corporate veil," resulting in personal liability for the business owner. These negative effects can occur in several different situations.

### Intermingling Funds

One of the most dangerous financial mistakes a business owner can make is to intermingle funds, such as paying personal expenses from the business checking account, or paying business expenses from the owner's personal account. This can be done with the best of intentions with the business owner making adjustments in the books to separate the business and personal transactions, but the behavior can leave openings for the IRS or courts to question the integrity of the business entity or the transactions. Failure to maintain complete financial separation between a business and its owners is one of the major causes of tax and legal trouble for small businesses.

**Tax problems.** Unintended consequences can occur when personal and corporate funds are intermingled. When a shareholder purchases an item for a corporation with personal funds, that shareholder is considered to have provided funds or made a contribution to the corporation. When a shareholder provides funds to or on behalf of a corporation, there are several different types of tax treatment that may apply, depending on the circumstances, and can be classified as one of the following transactions.

- Capital contribution.
- Loan to the corporation.
- Repayment of a loan from the corporation.
- Expense reimbursement.

On the other hand, when an individual takes funds from a corporation, the transaction can be classified as:

- Taxable dividend or distribution of profits.
- Nontaxable distribution.
- Nontaxable expense reimbursement.
- Taxable wages.
- Loan to the shareholder.
- Repayment of a loan from the shareholder.

Failure to carefully structure transactions can result in otherwise nontaxable transactions becoming taxable, in addition to a court piercing the corporate veil.

**Personal use of corporate assets.** If corporate assets are used for personal purposes, the IRS can reclassify expenses reported on the corporation tax return as expenses attributable to the shareholder rather than the corporation. On the other hand, if a corporation uses personal assets owned by the shareholder, this could indicate lack of separation of the shareholder and corporation.