C Corporation Distributions

Taxation of C-Corporations

For federal income tax purposes, a C-Corporation is a separate taxpaying entity. It conducts business, realizes net income or loss, pays taxes and distributes profits to shareholders. This creates a double tax. ***Income is taxed to the corporation when earned***, and ***taxed again when distributed*** to shareholders.

Unlike S Corporations and Partnerships, various types of income do not retain character as they pass through the C Corporation entity. A C Corporation does not act as a conduit when making distributions to shareholders.

Distributing to Shareholders

C-Corporations are separate entities from their owners. Its assets are ***not personal possessions*** of the shareholders. When a corporation distributes funds to a shareholder, the method of distribution determines the tax consequence.

A C-Corporation generally distributes money and property to a shareholder under one of the following methods:

1. Wages – Reasonable Compensation
2. Fringe Benefits – Health Insurance, Medical Reimbursement Plans, Pension Plans, Expense Reimbursements, Etc.
3. Rents – Home Office or Building Rent
4. Dividends – Not an Expense and Taxable to the Shareholder

Loans to the Shareholder

A C-Corporation can loan money to a shareholder. However, the IRS may reclassify the payment as a taxable dividend or compensation if it determines the arrangement is not a bona fide loan. Even with the proper paperwork in place, if the payment has characteristics of compensation ***(Wages)*** or a dividend payment ***(Dividends)***, the IRS can re-characterize it as a ***taxable distribution to the shareholder.***