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The Right Way to Ask Your S Corporation for Travel Reimbursements

Keep these basic rules in mind when you work in and operate your business as a corporation:

1. You are an employee of the corporation.
2. The corporation is a legal entity separate from you.
3. The corporation is the business.
4. You can incur business expenses on behalf of the corporation.
5. The corporation may reimburse you for the business expenses you incur on behalf of the corporation.

Now, let's say you incur expenses on behalf of your corporation, but you don't seek reimbursement from the corporation. Obviously, the corporation gets no deduction, because it has not paid for anything.

How about your claiming a deduction for the expenses you incurred as "employee business expenses"?

Bad Idea

Your claim of employee business expenses that you incurred on behalf of your corporation is a bad idea for three reasons:

1. It's most likely that the expenses were reimbursable by the corporation to you, and because you did not seek reimbursement, those expenses are not deductible by you as employee business expenses.¹



If the travel expenses incurred are your expenses by agreement with your corporation, then you deduct them as "itemized deductions," where they get included in the category where that group of deductions is reduced by 2 percent of adjusted gross income.²

3. If you are subject to the alternative minimum tax (AMT), employee business expenses give you zero benefit because such expenses are not deductible for the AMT.³ In other words, for AMT purposes, tax law simply does not recognize these deductions as deductions. That's unfair, of course, but then that's the AMT, and there's really little, if any, of the AMT that's even close to fair.

Good Idea

Submit an expense report to your corporation for reimbursement. With expense reimbursement, you get the best of all worlds. The corporation reimburses you for the expenses and it deducts the costs. You receive the reimbursements free of tax.

Horwath's Problem

Tibor Horwath and his wife owned 100 percent of their S corporation.

Mr. Horwath also operated a consulting business as a sole proprietorship and periodically consulted with the S corporation.

The S corporation got a contract from Primex Technologies, Inc., an unrelated third-party corporation (hereinafter Primex). In executing the contract with Primex, the S corporation contracted with Mr. Horwath's consulting proprietorship for some consulting on this contract.

During the proprietorship's consulting engagement with the S corporation, Mr. Horwath incurred \$16,812 of legitimate travel expenses while performing the contract, but he made a fatal error. He did not submit the travel expenses to his S corporation for reimbursement. Instead, he made a boo-boo and deducted the travel on his Schedule C sole proprietorship tax return.

The court ruled that Mr. Horwath's proprietorship gets no deductions for this travel because the expenses were S corporation expenses under the contract with Primex. In fact, Primex paid the S corporation for the travel expenses when the S corporation submitted them for reimbursement.⁴

This Gets Worse



The S corporation also gets no deduction. It collected the expense money from Primex, but it did not claim the expenses because it had not reimbursed Mr. Horwath. Now more than three years have passed, making it too late for the S corporation to amend its tax return and get this right.

The bottom line is that tax law gives Mr. Horwath the double tax whammy for his failure to obtain reimbursement of the travel expenses from his corporation. In this case, the law denied the expense deductions to both the proprietorship and the S corporation.

Planning Note

When you operate all or some of your business as a corporation, you must pay attention to the separate legal status of the corporation. You also have to honor the agreements you make with your corporation, even when you own 100 percent of the stock.

Because of tax law's abusive taxation of legitimate employee business expenses deducted on a personal tax return, make certain that your corporation reimburses you for 100 percent of your corporate incurred expenses so that

- the corporation gets a full tax deduction for the expenses, and
- you have zero taxable income from the expense reimbursements.

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1 Earl M. Coplon v Comm, TC Memo 1959-34; affirmed 277 F.2d 534 (6th Cir., 1960).

2 Noyce v Commr., 97 TC 670; IRC Section 67.

3 IRC Sections 55; 56(b)(1)(A)(i); 67(b).

4 Tibor Guenther Horwath v Commr., T.C. Memo 2004-213.

