Tax Tips

For Small Business

Summer 2007

The Tax Consequences of Loaning Money to Your Business

Don't forget the interest

Often business owners infuse their business with additional cash. How you structure this capital investment has a direct effect on the tax consequences. In addition, the type of entity you have created for your business also affects the tax consequences.

If you have loaned money to your business, you are required to charge interest on the loan; otherwise, interest will be imputed to you. This means that interest will be computed on the outstanding loan balance at the current rates and each payment will be considered to include interest. While you are required to report the interest as income on your personal return, your business is permitted a deduction for the interest paid.

When you make a loan to your business, it's important to charge an adequate rate of interest and document the loan with a stated repayment schedule. Failure to do so may cause the IRS to reclassify a loan as a contribution to capital. This could have unintended consequences. You will not recover a loan that is reclassified as a contribution to capital unless you withdraw money from your business. If your business is incorporated, generally this distribution must be made in the form of taxable wages or a taxable dividend. Repayments on a loan are not taxable to the extent of the principal.

Business Tax Credits That Save You Money

Claiming a credit can actually save you more tax dollars than taking a deduction

Are you missing out on any valuable tax credits? Tax credits reduce your tax liability dollar for dollar. Plus, you can carry any excess dollars forward to future years. Some of the credits you may be entitled to include: