5 tax-smart ways to take cash out of your C corporation

If you own a closely held C corporation, you might be looking for ways to withdraw cash from your business. Paying yourself a dividend can be a straightforward option — but it comes at a tax cost. Corporate distributions are generally taxable to you to the extent of your company's "earnings and profits," and your company can't deduct them. Distributions exceeding earnings and profits first reduce your stock basis; any remaining distribution is typically treated as capital gain. To avoid dividend treatment, consider these five alternative methods:

1. Repayment of shareholder loans *to* the corporation

If you've made bona fide loans to your corporation, it can generally repay the principal without the payment being treated as a dividend. A principal payment generally isn't taxable to you unless it exceeds your adjusted tax basis in the debt. Interest is taxable to you, and the corporation may deduct it, subject to applicable interest-deduction limitations and related-party timing rules.

Whether money you advance to your corporation is treated as debt (as opposed to a capital contribution) depends on the facts and circumstances. Proper documentation is important, but labeling an advance as a "loan" isn't enough. Relevant factors include whether:

- The arrangement has a fixed maturity date and interest rate.

- Your corporation is able to repay the loan.
- You've followed the loan agreement's terms.
- The corporation's debt-to-equity ratio supports debt treatment.

If an arrangement doesn't qualify as bona fide debt, payments to you may be treated as corporate distributions and taxed as dividends to the extent of your corporation's earnings and profits.

2. Loans *from* the corporation

You may be able to receive cash without immediate taxable income by borrowing it from your corporation. However, to prevent the loan from being treated as a corporate distribution, you must properly document it in a loan agreement or note. The terms should be comparable to those an unrelated lender would require, including a stated maturity date, a repayment schedule and an adequate interest rate. You should also have the ability and intent to repay the loan and make payments according to its terms.

A corporation can generally make de minimis loans of $10,000 or less to shareholders without charging interest. (The exception doesn't apply if tax avoidance is one of the principal purposes of the loan's interest arrangement.) If the aggregate outstanding balance exceeds $10,000, shareholder loans may be subject to a complicated set of "imputed" interest rules unless the corporation charges what the IRS considers an adequate rate of interest. Each month, the IRS publishes its applicable federal rates (AFRs), which vary depending on the loan's term.

A below-market loan may result in imputed interest. Depending on the circumstances, the interest the corporation has foregone may be treated as a constructive dividend or additional compensation to the shareholder receiving the loan. The corporation may deduct reasonable compensation, but it will be subject to payroll taxes. Both dividends and additional compensation may be taxable income to the shareholder personally. A canceled loan may also be treated as a constructive dividend. Be aware that your corporation must report interest income from shareholder loans.

3. Compensation

Your business can deduct reasonable compensation that you receive for services rendered to the corporation. So you may be able to take cash out of your corporation through a salary increase or bonus payment. However, it will be taxable to you as wages and subject to payroll taxes.

You may be able to obtain the equivalent of a cash withdrawal by receiving fringe benefits, which can sometimes be more tax-efficient than a raise or bonus. Certain benefits may be excluded from your taxable income, even though your corporation can generally deduct the related costs. Examples include:

- Employer-provided health coverage,
- Qualifying dependent care assistance,
- Certain retirement plan contributions, and
- Up to $50,000 of group-term life insurance coverage.

Each benefit has its own eligibility, dollar-limit and reporting requirements. In addition, highly compensated employees may lose some tax exclusions if a benefit plan discriminates in their favor.

You can also establish a written Section 125 cafeteria plan, sometimes called a salary reduction plan, that allows you (and other employees) to take a portion of compensation as qualifying tax-free benefits rather than as taxable compensation. The plan must satisfy specific eligibility, documentation and nondiscrimination requirements.

4. Rental payments

If you own real estate or equipment, you can lease it to your corporation. Your business may generally deduct reasonable rent as a business expense, and you'll receive a steady stream of rental payments. You must report these payments as rental income. The tax treatment may be affected by the passive activity and self-rental rules.

Rental rates should reflect the market value of the property provided. If rent is considered excessive, the excess may be treated as a constructive dividend, and your corporation won't be able to deduct it as a business expense.

5. Property sales

You can get cash from the corporation by selling property to it. However, certain sales have unfavorable tax consequences. For example, you generally can't claim a loss on the sale of property to a corporation you own more than 50% of. And gain from the sale of depreciable property to a more than 50%-owned corporation is generally treated as ordinary income, rather than capital gain.

A sale should have a legitimate business purpose and terms comparable to those an unrelated third party would accept. If your corporation pays more than fair market value, the excess may be treated as a constructive dividend. You may need to obtain an independent appraisal to establish the property's value.

Year-end planning

If you'd like to receive additional cash or benefits before year end, it's important to evaluate the tax implications for both you and your corporation. Contact us before proceeding. We can help you sort through your options and review your 2026 shareholder-corporation transactions to ensure proper documentation and classification.