



S Corporation Employees, Shareholders and Corporate Officers

Who is an Employee?

The definition of employee for FICA (Federal Insurance Contributions Act), FUTA (Federal Unemployment Tax Act) and federal income tax withholding under the Internal Revenue Code include corporate officers. When corporate officers perform a service for the corporation and receive or are entitled to payments, those payments are considered wages.

The fact that an officer is also a shareholder does not change this requirement. Such payments to the corporate officer are treated as wages. Courts have consistently held S corporation officers/shareholders who provide more than minor services to their corporation and receive, or are entitled to receive, compensation are subject to federal employment taxes.

If an officer does not perform any services or only performs minor services and is not entitled to compensation, the officer would not be considered an employee.

Distributions, Dividends and Other Compensation as Wages

Courts have found shareholder-employees are subject to [employment taxes](#) even when shareholders take distributions, dividends or other forms of compensation instead of wages.

In 2001, in a Tax Court case against a Veterinary Clinic, the Tax Court ruled that an employer cannot avoid federal taxes by characterizing compensation paid to its sole director and shareholder as distributions of the corporation's net income rather than wages. *Veterinary Surgical Consultants, P.C. vs. Commissioner*, 117 T.C. 141 (2001)

The Sixth Circuit held that a shareholder-employee of a company used the company bank account for personal use. As such, the Court ruled the shareholder was an employee and owed employment tax. *Joly vs. Commissioner*, 211 F.3d 1269 (6th Cir., 2000)

In yet another similar case, the Tax Court held that an accountant was taking dividends and performing duties for the company. The Tax Court ruled the dividends were actually wages, subject to employment taxes. *Joseph M. Grey Public Accountant, P.C. vs. Commissioner*, 119 T.C. 121 (2002)

If cash or property, or the right to receive either, did go to the shareholder, a salary amount must be determined and the level of salary must be reasonable and appropriate. See the [S Corporation Compensation and Medical Insurance Issues](#) page for more details on what is considered to be reasonable compensation.

References/Related Topics

- [S Corporations](#)
- [S Corporation Compensation and Medical Insurance Issues](#)
- [S Corporation Stock and Debt Basis](#)
- Special Rules for Health Insurance Costs of 2-Percent Shareholder-Employees ([IRB 2008-2 Notice 2008-1](#))
- [Other Business Structures](#)

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