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Internal Revenue Service  
**Memorandum**

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subject: Treatment of expenses incurred on behalf of joint venture

This memorandum responds to your request for assistance. This advice may not be used or cited as precedent.

**ISSUES**

May a corporation treat the costs of services it performs on behalf of its joint venture as capital contributions, thus increasing the corporation's basis in the joint venture?

**CONCLUSIONS**

Yes, the costs of services performed on behalf of the joint venture are not deductible business expenses under section 162, but are contributions to the joint venture's capital.

**FACTS**

joint ventures, all of which are treated as corporations for federal income tax purposes, are.















## LAW AND ANALYSIS

Section 162(a) allows a deduction for ordinary and necessary business expenses, including a reasonable allowance for salaries or other compensation for personal services actually rendered. "Business expenses which satisfy the ordinary and necessary expense requirements of section 162 are deductible if they are 'proximately connected to the business of the taxpayer claiming deduction therefore \* \* \*.'" Young & Rubicam, Inc. v. United States, 410 F.2d 1233, 1238 (Ct. Cl. 1969) (quoting Eustice, Tax Problems Arising from Transactions Between Affiliated or Controlled Corporations, 23 Tax L. Rev. 451, 475). Generally, a corporation may not deduct expenses paid on behalf of a related corporation. See Interstate Transit Lines v. Commissioner, 319 U.S. 590 (1943); Deputy v. Dupont, 308 U.S. 488 (1940). However, there is a limited exception to this rule. A section 162 deduction may be allowable by a corporation if it

paid the related corporation's business expense for its own direct and proximate benefit or the expense was incurred by the corporation with the underlying motivating purpose of protecting and promoting its own business. See Young & Rubicam, 410 F.2d at 1238-39; Lohrke v. Commissioner, 48 T.C. 679 (1967); Columbian Rope Co. v. Commissioner, 42 T.C. 800, 815-16 (1964).

In order for compensation and related payments to be for the taxpayer's own direct and proximate benefit, the taxpayer "must prove that the specific services performed by each of the employees involved were for its direct and proximate benefit. The general and indirect benefit which obviously inures to a parent corporation when one of its subsidiaries successfully performs its functions does not satisfy the requirements of section 162." Young & Rubicam, 410 F.2d at 1238.

In Young & Rubicam, the parent corporation sent certain employees abroad to assist its foreign subsidiaries and paid these employees' compensation and related expenses while abroad. 410 F.2d at 1236-37. In determining whether the parent corporation was allowed to deduct these expenses, the court in Young & Rubicam stated that a taxpayer "cannot claim as its own expense, compensation paid for activities that were concerned with the day-to-day operation of the subsidiary corporation's business. Any benefit to [the taxpayer] from these activities cannot be considered proximate and direct to its own business and, therefore, these expenses are not allowable deductions under section 162." 410 F.2d at 1239.

"Payments made by a stockholder of a corporation for the purpose of protecting his interest therein must be regarded as additional cost of his stock and such sums may not be deducted as ordinary and necessary expenses." Eskimo Pie Corp. v. Commissioner, 4 T.C. 669, 676 (1945), aff'd per curiam 153 F.2d 301 (3<sup>rd</sup> Cir. 1946); Estate of Steckel v. Commissioner, 26 T.C. 600, 607 (1956), aff'd per curiam 253 F.2d 267 (6<sup>th</sup> Cir. 1958); South American Gold & Platinum Co. v. Commissioner, 8 T.C. 1297, 1302 (1947), aff'd per curiam, 168 F.2d 71 (2d Cir. 1948).

Rev. Rul. 84-68, 1984-1 C.B. 31, holds that a parent corporation may not deduct as a business expense under section 162 the cash bonuses that it pays to employees of its wholly owned subsidiary. Instead, the payment is treated as a contribution to the subsidiary's capital accompanied by a constructive payment by the subsidiary of the cash bonuses to its employees for which the subsidiary is entitled to a deduction.

"[A] contribution to capital need not be made pro rata with contributions from other shareholders." Lackey v. Commissioner, T.C. Memo. 1977-213. "[A] payment to a corporation can be a capital contribution even if some shareholders contribute less than others or nothing at all." Board of Trade of City of Chicago v. Commissioner, 106 T.C. 369, 378 (1996). A contribution to capital may occur even if it "is not recorded as a contribution to capital on the corporation's balance sheet." Commissioner v. Fink, 483 U.S. 89, 97 (1987).

In this case, the taxpayer paid for services performed on behalf of its joint venture. Expenses for the operation of a subsidiary's business that do not provide a proximate and direct benefit to the taxpayer are not deductible. See Young & Rubicam, 410 F.2d at 1238-39. The benefit that inures to a parent corporation when its subsidiary successfully performs its functions does not meet the requirements of section 162. See id. at 1238.

However, while payments by a stockholder to protect his investment may not be deducted as ordinary and necessary business expenses, they are an additional cost of his stock. See Eskimo Pie Corp., 4 T.C. at 676; Estate of Steckel, 26 T.C. at 607; South American Gold & Platinum Co., 8 T.C. at 1302. Rev. Rul. 84-68 treated cash bonuses paid by a parent corporation to employees of its wholly owned subsidiary as a contribution to the capital of the subsidiary accompanied by the subsidiary's constructive payment of the cash bonuses to its employees for which it was entitled to a deduction. This case differs slightly from Rev. Rul 84-68 in that the taxpayer paid its employees, not the joint venture's employees, and the joint venture is not wholly owned. With respect to the former, payments to the taxpayer's employees for services performed on behalf of a subsidiary should be treated the same way as payments to the subsidiary's employees. Cf. Young & Rubicam, 410 F.2d at 1238-39. With respect to the latter, a less than 100 percent shareholder may make a capital contribution even though it is not made pro rata with contributions from other shareholders and some shareholders contribute nothing at all. See Lackey, T.C. Memo. 1977-213; Board of Trade of City of Chicago, 106 T.C. at 378. Similarly, the fact the joint venture may not record the payment of the expenses as a contribution to capital does not stop the contribution to capital from occurring. See Fink, 483 U.S. at 97.

Therefore, the expenses for the services provided to the joint venture should be treated as a contribution of capital to the joint venture by the taxpayer accompanied by a constructive payment of the expenses by the joint venture for which it is entitled to a deduction.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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