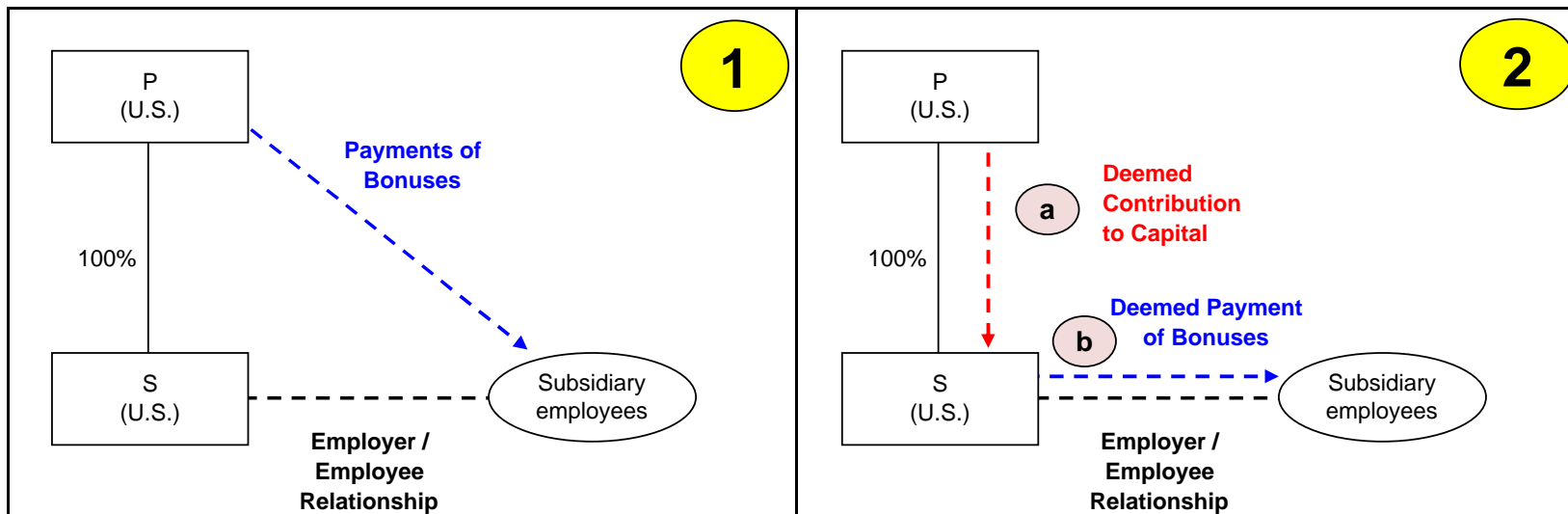


**Parent Payment of Bonuses to Subsidiary Employees**

Actual Transaction

Deemed Transactions



A domestic corporation, P, established a bonus program for the employees of its wholly owned domestic subsidiary, S. Under the program, P pays cash bonuses in December of each year to S's employees for their past services performed for S during the calendar year. The total compensation paid to these employees, including the cash bonuses, is reasonable remuneration for the services rendered. None of these employees perform any services for P. The employees who receive the bonuses include them in income in the year received.

A taxpayer may not deduct the expenses of another, even though those expenses would otherwise be ordinary and necessary trade or business expenses. A parent corporation may not therefore deduct compensation paid by it to the employees of its wholly owned subsidiary, even though the indirect benefit of their services inures to the parent corporation as sole shareholder of the employer. A cash payment by a shareholder for the benefit of a corporation in which the shareholder owns stock is recognized for federal income tax purposes as a contribution of capital to the corporation.

The cash bonuses paid by P to employees of S is deemed to be a capital contribution by P to S. The bonuses paid to S's employees is in turn deemed to be paid from S's own funds.