

Can a Personal Service Corporation also elect IRS Sub-Chapter S corporate status? This is a GREAT question that I've been getting lately. The basic answer is it depends. My Bible the Internal Revenue Code (IRC) 448(d)(2) defines a qualified personal service corporation as an entity where substantially all of the activities involve the performance of services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting, and substantially all of the stock of which (by value) is held directly (or indirectly through 1 or more partnerships, S corporations, or qualified personal service corporations). IRC 269A clearly states that a personal service corporations (PSC) formed or availed of to avoid or evade income tax by reducing the income of, or securing the benefit of any expense, deduction, credit, exclusion, or other allowance for, any employee-owner which would not otherwise be available, then the Secretary may allocate all income, deductions, credits, exclusions, and other allowances between such personal service corporation and its employee-owners, if such allocation is necessary to prevent avoidance or evasion of Federal income tax or clearly to reflect the income of the personal service corporation or any of its employee-owners. **So yes it is a violation of the tax code as I understand it to elect to be a small business simply in an effort to recognize losses on a PSC that is no longer operational. You either loose those losses or you figure out a way for the PSC to make \$\$ to offset losses.** However there is no language in IRC 1362 prohibiting a viable ongoing PSC from filing [IRS Form 2553 Election by a Small Business Corporation](#) .

The Sub chapter S corporation is a variation of the standard corporation. The S corporation allows income or losses to be passed through to individual tax returns, similar to a partnership. The rules for Subchapter S corporations are found in Sub chapter S of Chapter 1 of the Internal Revenue Code. An S corporation has the same corporate structure as a standard corporation. It is a legal entity, chartered under state law, and is separate from its shareholders and officers. There is generally limited liability for corporate shareholders. The difference is that the corporation files an election on Form 2553, Election by a Small Business Corporation, to be treated differently for federal tax purposes. Generally, an S corporation is exempt from federal income tax other than tax on certain capital gains and passive income. It is treated in the same way as a partnership, in that generally taxes are not paid at the corporate level. An S corporation files Form 1120S, U.S. Corporation Income Tax Return for an S Corporation. The income flows through to be reported on the shareholders' individual returns. Schedule K-1, Shareholder's Share of Income, Credits and Deductions, is completed with Form 1120S for each shareholder. The Schedule K-1 tells shareholders their allocable share of corporate income and

deductions. Shareholders must pay tax on their share of corporate income, regardless of whether it is actually distributed.

IRC 1362 address the election; revocation and; termination of Sub-chapter S status. In general a small business corporation may elect, in accordance with the provisions of this section, to be an S corporation if all shareholders consent to the election and the election is timely made and the entity is not listed as an ineligible corporation (bank, insurance company, 'possession corporation', or a domestic international sales corporation). It also helps make things less complicated if the tax year is the same as the calendar year for the PSC in question electing the Sub S status. A tax year is the annual accounting period a corporation uses to keep its records and report its income and expenses. Generally, corporations can use either a calendar year or a fiscal year as its tax year. A corporation must adopt a tax year by the due date (not including extensions) of its first income tax return.

IRC 441(i) states that a personal service corporation must use a calendar year as its tax year unless: It elects to use a 52-53 week tax year that ends with reference to the calendar year; It can establish a business purpose for a different tax year and obtains approval of the IRS. See [Form 1128, Application To Adopt, Change, or Retain a Tax Year](#), and [Publication 538](#); or It elects under section 444 of the Internal Revenue Code to have a tax year other than a calendar year. Use Form 8716, Election to Have a Tax Year Other Than a Required Tax Year, to make the election. If a personal service corporation makes a section 444 election, its deduction for certain amounts paid to employee-owners may be limited. See Schedule H (Form 1120), Section 280H Limitations for a Personal Service Corporation (PSC), to figure the maximum deduction.

John R. Dundon, EA - 720-234-1177 - jddundon@comcast.net - <http://prep.1040.com/jd/> - Enrolled with the United States Department of Treasury to Practice before the IRS - Enrolled Agent # 85353. Under contract with the IRS as a Certified Individual Taxpayer Identification Number (ITIN) Acceptance Agent - I am a Federally Authorized Tax Practitioner (USC 31 Section 330 + IRC 7525a.3.A) regulated under US Treasury Cir. 230.