SCHEDULE H
(Form 1120)

Department of the Treasury
Internal Revenue Service

Section 280H Limitations for a Personal Service Corporation (PSC)

© Attach to PSC's income tax return if Part II is completed.

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Note: A newly organized PSC is considered to have met the section 280H distribution requirements for the first year of its existence and does not have to complete Schedule H. If, during the tax year, an existing corporation becomes a PSC and makes a

Part I

For 2nd tax year before applicable election year . . . . . .

Part II

Instructions

Section references are to the Internal Revenue Code.

Purpose of Schedule

Schedule H is used by personal service corporations (PSCs) (as defined in section 441(i)(2)) that have elected under section 444 to have a tax year other than a calendar year. A PSC that makes the election is subject to the minimum distribution requirement of section 280H for the year the election is made and for each tax year the election remains in effect. If the PSC does not meet the requirement, its deduction for amounts paid or incurred to employee-owners (see Applicable amount, below) is limited.

Part I is used to determine if the PSC meets the minimum distribution requirement of section 280H(c) for the tax year. Part II is used to figure the limits on deductions under section 280H(d) if the requirement is not met.

Who Must File

A PSC that has elected under section 444 to have a tax year other than a calendar year must complete Schedule H. If it does not meet the minimum distribution requirement of section 280H for the tax year, it must attach Schedule H to its Form 1120.

If a PSC meets the requirement, it does not need to file the completed Schedule H with the tax return, but it should keep Schedule H with the PSC's tax records.

Definitions

Applicable election year.Ð An applicable election year is any tax year in which a section 444 election is in effect.

Applicable amount.Ð An applicable amount is any amount otherwise deductible by a PSC in a tax year that is includible (directly or indirectly) in the gross income of any taxpayer who is an employee-owner during that year. Temporary Regulations section 1.280H-1T(b)(4)(iii) contains examples of how to figure a PSC's applicable amounts.

Exception. Dividends paid by the corporation and gain on the sale or exchange of property between the owner-employee and the corporation are not applicable amounts.

An amount is indirectly includible in the gross income of an employee-owner if it is includible in the gross income of certain related parties. For details, see Temporary Regulations section 1.280H-1T(b)(4)(ii).

Employee-owner.Ð An employee-owner is a person who:

c On any day of the PSC's tax year, is an employee of the PSC or who performs services for or on behalf of the PSC (including an independent contractor), and

c On any day of the PSC's tax year, owns any outstanding stock of the PSC.

Deferral period.Ð The deferral period is the number of months between the last day of the elected tax year and the last day of the required tax year.

Example. The PSC elects a tax year that ends on September 30. Since the required tax year for a PSC is the calendar year, the deferral period is 3 months (the number of months between September 30 and December 31).

Nondeferral period.Ð The nondeferral period is the part of the tax year that occurs after the part of the year that constitutes the deferral period.

Adjusted taxable income. Ð Adjusted taxable income is taxable income without regard to:

c Applicable amounts, and

c Any NOL carryover to the extent the carryover is attributable to applicable amounts.

Adjusted taxable income for the deferral period of an applicable election year is the adjusted taxable income that would result if the PSC filed an income tax return for the deferral period under its normal method of accounting. Reasonable estimates are acceptable.

For more information, see Temporary Regulations section 1.280H-1T (c)(3)(iii).

Part I

Complete Part I to see if the PSC meets the minimum distribution requirement of section 280H(c). The PSC meets the requirement if, during the deferral period of the tax year, the applicable amounts paid or incurred for all employee-owners are equal to or greater than the smaller of:

c The amount determined under the preceding year test, or

c The amount determined under the 3-year average test.

Use lines 1 through 4 to see if the preceding year test applies to the PSC. If it doesn't, complete the rest of Part I to see if the 3-year average test applies.

See Temporary Regulations section 1.280H-1T(c) for more information, including examples of the computation of the preceding-year test and the 3-year average test.

Part II

Use Part II to figure the maximum deduction for applicable amounts if the PSC did not meet the minimum distribution requirement figured in Part I.