

**COMPUTATION OF UNITED STATES PERSONAL SERVICE CORPORATION INCOME**

For Calendar Year 1951

or taxable year beginning \_\_\_\_\_, 1951, and ending \_\_\_\_\_, 1952

<p>This schedule must be filed IN DUPLICATE with and as part of the corporation's income tax return. (See Instruction 1.)</p>	<p><b>PRINT PLAINLY CORPORATION'S NAME AND ADDRESS</b></p> <p>-----                  (Name)                  -----                  (Street and number)                  -----                  (City or town, postal zone number) (State)                  -----</p> <p>Kind of business -----</p>	<p>THE FILING OF THIS SCHEDULE WITH AND AS A PART OF FORM 1120 WILL CONSTITUTE AN ELECTION UNDER SECTION 449 (b) OF THE INTERNAL REVENUE CODE NOT TO BE SUBJECT TO THE EXCESS PROFITS TAX.</p>
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**Schedule PS-1.—UNDISTRIBUTED SUPPLEMENT S NET INCOME COMPUTATION**

1. Net income. (See Instruction 6).....	\$ .....	
2. Add: Contributions or gifts deducted in computing item 1 (see line 5, below).....		
3. Total of lines 1 and 2.....	\$ .....	
4. Less: Federal income tax. (See Instruction 8).....	\$ .....	
5. Contributions or gifts paid. (From Schedule PS-3.) (See Instruction 9 for limitation).....		
6. Supplement S net income (line 3 minus total of lines 4 and 5).....	\$ .....	
7. Less: Dividends paid. (From Schedule PS-4).....		
8. Undistributed Supplement S net income.....	\$ .....	

**Schedule PS-2.—SHAREHOLDERS' HOLDINGS AND SHARES OF INCOME. (See Instruction 11)**

1. Name and address of each shareholder at end of taxable year. (Designate nonresident aliens) (Where return of shareholder is filed in another collection district, specify district)	Stockholdings at end of year		4. Share of undistributed Supplement S net income (line 8 above)	5. Share of interest; Government obligati
	2. Class of shares and par value	3. Number of shares of each class		
(a) .....			\$ .....	\$ .....
(b) .....				
(c) .....				
(d) .....				
(e) .....				
(f) .....				
(g) .....				
(h) .....				
<b>TOTALS</b> .....			\$ .....	\$ .....

**Schedule PS-3.—CONTRIBUTIONS OR GIFTS PAID. (See Instruction 9)**

Name and Address of Organization	Amount
	\$
<b>TOTAL.</b> (Enter as line 5, Schedule PS-1, subject to 15 percent limitation)	\$

**Schedule PS-4.—DIVIDENDS PAID. (See Instruction 10)**

Distributions Out of Earnings or Profits of the Taxable Year or Out of Earnings or Profits Accumulated Since February 28, 1913 (Indicate dates paid)	1. Taxable Distributions	2. Nontaxable Distributions
1. Cash	\$	X X X X X X X X X X X X
2. Assets other than cash or the corporation's own securities: (See notes 1 and 5.) (Indicate nature of assets.)		X X X X X X X X X X X X
3. Treasury stock. (See notes 1 and 5)		\$
4. Obligations of the corporation (bonds, notes, script, etc.). (See notes 3 and 5)		X X X X X X X X X X X X
5. Common stock of the corporation distributed to holders of common stock. (See notes 2 and 5)		\$
6. Preferred stock of the corporation distributed to holders of common stock. (See notes 2, 4, and 5)		
7. Common stock of the corporation distributed to holders of preferred stock. (See notes 2, 4, and 5)		
8. Preferred stock of the corporation distributed to holders of preferred stock. (See notes 2, 4, and 5)		
9. Optional—Medium of payment elected by stockholders:		
(a) Cash		X X X X X X X X X X X X
(b) Common stock. (See notes 2 and 5)		X X X X X X X X X X X X
(c) Other. (See note 5.) (Specify nature)		X X X X X X X X X X X X
10. Total of lines 1 to 9	\$	\$

1. Enter the lesser of the two following amounts determined as of time of payment: (a) The adjusted basis in the hands of the corporation as provided in section 113 of the Internal Revenue Code; or (b) the fair market value.
2. Enter the amount of the fair market value at time of payment.
3. Enter the lesser of the two following amounts determined as of the time of payment: (a) Face value; or (b) fair market value.
4. Preferred stock for this purpose should be considered as stock which is preferred as to either dividends or assets, irrespective of formal designation.
5. Distributions in the form of rights to purchase assets or subscribe to stock or other obligations of the corporation should be entered in the item applicable to the assets, stocks, or other obligations for which rights were distributed.

In addition to filling in the foregoing schedules, the corporation should attach a statement showing: (1) The character, preferences, dividend rates, and other essential features of the various classes of its stock outstanding for any time during the taxable year; (2) the names and addresses of its several shareholders and their relationship to each other; (3) the number and classes of shares owned at any time during the taxable year by each shareholder and the portion of the year during which such shares were so owned; (4) the nature of the activities of the several shareholders on behalf of the corporation; and (5) the extent to which capital in any form is used in the business.

# INSTRUCTIONS FOR SCHEDULE PS (Form 1120)

## COMPUTATION OF UNITED STATES PERSONAL SERVICE CORPORATION INCOME

(References are to the Internal Revenue Code, unless otherwise noted)

**1. Taxation of personal service corporations.**—A personal service corporation is subject to the excess profits tax imposed under Subchapter D of Chapter 1 the same as any other domestic corporation unless it elects as to any taxable year not to be subject to such tax. Such an election may not be exercised by a corporation if it is a member of an affiliated group filing a consolidated return under section 141. If the corporation elects not to be subject to the excess profits tax, the provisions of Supplement S (sections 391 to 396, inclusive) shall apply to the shareholders in such corporation who were such shareholders on the last day of the taxable year of the corporation. See section 394 and the regulations thereunder. In such case, the amount of the undistributed Supplement S net income shall be considered as paid in to the corporation as of the close of the taxable year as paid-in surplus or as a contribution to capital, and the amount of accumulated earnings and profits as of the close of such year shall be correspondingly reduced if such amount or any portion thereof is required to be included as a dividend in the gross income of the shareholder. See section 394 (d).

**2. Definition of personal service corporation.**—(a) *In general.*—The term “personal service corporation” means a domestic corporation in which capital is not a material income-producing factor and the income of which is to be ascribed primarily to the activities of shareholders who (1) are regularly engaged in the active conduct of the affairs of the corporation, and (2) are the owners, throughout the entire taxable year, of at least 70 percent in value of each class of stock of the corporation.

If 50 percent or more of the gross income of a corporation consists of gains, profits, or income derived from trading as a principal, such corporation cannot be considered to be a personal service corporation. As to corporations in which less than 50 percent of the gross income is derived from trading as a principal, see (c) below.

(b) *Stock interest of shareholders.*—Shareholders regularly engaged in the active conduct of the affairs of the corporation and to whom the income of the corporation is primarily to be ascribed must own at all times during the taxable year at least 70 percent in value of each class of stock of the corporation. If stock is owned by the spouse or minor child of an individual, or owned by the guardian or trustee of such spouse or child, such stock is treated as being owned by such individual.

A corporation cannot be considered to be a personal service corporation for any taxable year if another corporation owns more than 30 percent in value of any class of its stock at any time during such year. A corporation is an artificial entity and cannot itself be regularly engaged in the active conduct of the affairs of another corporation within the meaning of section 449.

The fact that the ownership of shares in the corporation may change during the course of the taxable year does not take the corporation which is otherwise a personal service corporation out of that class unless at some time during the taxable year the ownership of more than 30 percent in value of the shares of any class of stock passes into the hands of persons not regularly engaged in the active conduct of the affairs of the corporation.

(c) *Income to be ascribed primarily to the activities of shareholders.*—If employees other than shareholders contribute substantially to the services rendered by a corporation, such corporation is not a personal service corporation unless, in every case in which services are so rendered, the value of and the compensation charged for such services are to be attributed primarily to the experience or skill of the shareholders and such fact is evidenced in some definite manner in the normal course of the business or profession. The fact that the shareholders give personal attention or render valuable services to the corporation as a result of which its earnings are greater than those of a corporation engaged in a like or similar business or profession, the shareholders of which are not regularly engaged in the activities of the corporation, does not of itself constitute the corporation a personal service corporation.

Income of a corporation from merchandising or trading as a principal, directly or indirectly, in commodities or in the services of others is not to be ascribed primarily to the activities of its shareholders. Income of a corporation from the conduct of an auction, agency, brokerage, or commission business strictly on the basis of a fee or commission may be so ascribed. If, however, either as a matter of business policy or by contract, the corporation assumes any such risks as those of market fluctuations, bad debts, or failure to accept shipments, or if it guarantees the accounts of the purchaser or is in any way accountable to the seller for the payment of the purchase price, the transaction is one of merchandising or trading, and this is true even though the goods are shipped directly from the producer to the consumer and are never actually in the possession of the corporation. The fact that earnings of the corporation are termed commissions or fees is not controlling. The fact that a commission or fee in a transaction is based on a difference in the prices at which the seller sells and the buyer buys raises a presumption that the transaction is one of merchandising or trading, and it will be so considered in the absence of satisfactory evidence to the contrary.

It may happen that a corporation is engaged in two or more businesses or professions which are more or less related. Thus, an engineering concern may also engage in contracting, which amounts to trading in materials and labor, or a brokerage concern may guarantee some of its accounts, or a photographic concern may sell pictures, frames, art

goods, and supplies. In such cases, the corporation is not a personal service corporation unless the activities of the corporation consisting of trading or guaranteeing of accounts or selling are negligible or merely incidental, and unless no appreciable part of the earnings is to be ascribed to such activities. See also (e) below relating to the employment of capital.

(d) *Shareholders regularly engaged in the active conduct of the affairs of the corporation.*—A corporation is not a personal service corporation unless shareholders who own at all times during the taxable year at least 70 percent in value of each class of stock are regularly engaged in the active conduct of the affairs of the corporation. That such shareholders devote some of their time to the affairs of the corporation is not sufficient; they must with regularity devote substantial time and energy to the conduct of its affairs.

(e) *Capital as a material income-producing factor.*—In a personal service corporation capital must not be a material income-producing factor. Whether capital is a material income-producing factor is to be determined by reference to (a) the extent to which capital is required to carry on the business or profession, and (b) the extent to which capital is actually used in the production of income though not required by the primary activities of the corporation. If the use of capital is necessary to the production of the income of the corporation and is more than incidental, capital is a material income-producing factor and the corporation is not a personal service corporation. If a substantial portion of the income is attributable to a use of capital, whether or not connected with the primary activities of the corporation, capital is a material income-producing factor even though such use of capital is not necessary to such primary activities. The term “capital” as used in section 449 means not only capital actually invested by the shareholders but also capital obtained in other ways. Thus, capital may be borrowed either directly as shown by bonds, debentures, certificates of indebtedness, notes, bills payable, or other paper, or indirectly as shown by accounts payable or other forms of credit, or the business of the corporation may be financed in some other manner by its shareholders. If a substantial amount of capital is used to finance or carry the accounts of clients or customers, it will be inferred that because of competition or for other reasons such use of capital is necessary and more than incidental in order to secure or hold business which would otherwise be lost. If a corporation engaged in an agency, brokerage, or commission business regularly employs a substantial amount of capital to lend to its principals, to buy and carry goods on its own account, or to buy and carry odd lots in order that it may render more satisfactory service to its principals or customers, such corporation is not a personal service corporation. In general, the larger the amount of capital actually used the stronger is the evidence that capital is necessary, more than incidental, and is a material income-producing factor.

The term “income” as used in section 449 means gross income. Capital is a material income-producing factor if its use results in a substantial amount of gross income, irrespective of the amount of net income, if any, such use produces.

(f) *Application of regulations; returns.*—No definite and conclusive tests can be prescribed by which it can be finally determined in advance of an examination of the corporation's income-tax return whether it is or is not a personal service corporation. In the preceding paragraphs are set forth the general principles under which such determination will be made.

If a corporation claiming to be a personal service corporation signifies in its return under Chapter 1 for any taxable year its desire not to be subject to the excess profits tax under Subchapter D of Chapter 1 for such taxable year, it shall attach Schedule PS (Form 1120), in duplicate, to its income-tax return on Form 1120.

**3. Election as to taxability.**—The election as to taxability provided for in section 449(b) and the resulting exemption from tax have application only to the excess profits tax on domestic corporations imposed under Subchapter D of Chapter 1. The election shall be made by filing Schedule PS (Form 1120), with and as a part of, the corporation income-tax return on Form 1120. A new election is required for each taxable year. An amended return filed after the statutory period for filing the return (or after the last day of any extension period) is not a return within the meaning of section 449(b).

**4. Supplement S net income.**—The term “Supplement S net income” means the net income as defined in section 21, but computed without the deduction allowed under section 23(q), minus the sum of the following:

(a) The Federal income tax payable under Chapter 1 for the taxable year; and

(b) The amount of contributions or gifts made to or for the use of donees described in section 23(q) for the purposes therein specified, to an amount which does not exceed 15 percent of the net income of the corporation computed without the benefit of sections 23(q) and 393(b).

The deductions allowed under section 393 for contributions or gifts made to or for the use of donees described in section 23(q) are in lieu of deductions otherwise allowable under section 23(q) and are allowable only for the taxable year in which such contributions or gifts are actually paid, regardless of when pledged and regardless of the method of accounting employed by the corporation in keeping its books and records.

The provisions of the regulations under section 23(o) relating to (1) the statement in returns of the name and address of each organization to which a contribution or gift was made and the amount and the approximate date of the actual payment of the contribution or gift, (2) the substantiation of the claims for deductions when required by the Commissioner, and (3) the basis for calculation of the amount of a contribution or gift which is other than money, are equally applicable to claims for deductions of amounts of contributions or gifts by corporations under section 393.

**5. Definition of undistributed Supplement S net income.**—The term "undistributed Supplement S net income" means Supplement S net income (as defined in section 393) minus the amount of dividends paid by the corporation during the taxable year. For the method of computing dividends paid, see subsections (d), (e), (f), (g), (h), and (i) of section 27 and the regulations thereunder.

#### SUPPLEMENT S NET INCOME COMPUTATION

**6. Net income.**—Enter in line 1 the net income for the taxable year computed in accordance with the provisions of Chapter 1. In the case of domestic corporations this item will be the amount shown as item 34, Form 1120.

**7. Contributions or gifts deducted under section 23(q).**—Section 23(q) provides for the deduction of certain contributions or gifts, to the extent of 5 percent of the net income computed without the benefit of such deduction, while section 393 provides that in computing Supplement S net income there shall be allowed in lieu of the deduction allowed by section 23(q) contributions or gifts of the specified types to an amount which does not exceed 15 percent of the net income computed without the benefit of such deduction and the deduction allowed under section 23(q). Provision for deduction of the allowance is made in line 5 and in order to show the amount of income upon which the increased limitation is based, the amount allowed under section 23(q) and deducted in computing net income under Chapter 1 (line 1) should be entered as line 2. (See Instruction 9.)

**8. Federal income tax.**—Section 393(a) provides that there shall be allowed as an additional deduction:

"(a) The Federal income tax payable under this chapter for the taxable year;"

In the case of domestic corporations this item will be the amount shown in item 39, Form 1120.

**9. Contributions or gifts deductible under section 393(b).**—Section 393(b) provides for the allowance of an additional deduction as follows:

"(b) In lieu of the deduction allowed by section 23(q), contributions or gifts, payment of which is made within the taxable year, to or for the use of donees described in section 23(q) for the purposes therein specified, to an amount which does not exceed 15 per centum of the corporation's net income, computed without the benefit of this subsection and section 23(q)."

As noted under Instruction 7, above, the amount deducted under section 23(q) in computing net income is to be restored to income under line 2. Furnish in Schedule PS-3 details of contributions or gifts paid within the taxable year to or for the use of donees described in section 23(q), and enter the total amount thereof in line 5 except where such total exceeds 15 percent of the amount shown in line 3, in which case the amount to be entered in line 5 is 15 percent of the amount shown in line 3.

#### UNDISTRIBUTED SUPPLEMENT S NET INCOME COMPUTATION

**10. Dividends paid.**—Enter in line 7 the amount of dividends paid computed in the same manner as provided in (d), (e), (f), (g), (h), and (i) of section 27 and the regulations thereunder for the purpose of the basic surtax credit provided in section 27. Such amount may be computed in Schedule PS 4, and there should be attached to the return (A) a true copy of each dividend resolution and (B) a concise statement of the pertinent facts relating to the payment of each dividend, clearly specifying (1) the medium of payment and (2), if not paid in money, the fair market value and adjusted basis (or face value, if paid in the corporation's own obligations) on the date of distribution of the property distributed, and the manner in which such fair market value and adjusted basis were determined.

#### CORPORATION INCOME TAXED TO SHAREHOLDERS

**11. Shareholders' holdings and shares of income.**—Enter the names and addresses of the shareholders who were shareholders on the last day of the taxable year on lines (a), (b), (c), etc., in column 1, Schedule PS-2, and extend in the proper columns each shareholder's stockholdings at the end of the year and his share of income. In determining the shareholders' proportionate shares of the interest specified in section 25(a) (1) or (2) which is included in the gross income of the corporation reference should be made to items 10 (a) and 10 (b), Form 1120. Each shareholder should be advised by the corporation of his proportionate share of income as shown in Schedule PS-2.

**12. Taxability of shareholders.**—If, by reason of an election under section 449, a personal service corporation is exempt for any taxable year from the excess profits tax imposed under Subchapter D of Chapter 1, the undistributed Supplement S net income of the corporation shall be treated as a dividend received by those who, at the close of the taxable year of the corporation, were the shareholders of the corporation and as such would have been entitled to receive such income as a dividend had it been distributed at that time. Each such shareholder for his taxable year in which or with which the taxable year of the corporation ends, shall include in his gross income his proportionate share of such undistributed Supplement S net income as though such proportionate share had been received as a dividend on the last day of the taxable year of the corporation. Such amount is to be determined by reference to the interest of the shareholder in the corporation, that is, by reference to the number of shares of stock owned and the relative rights of each class of stock if there are several classes of stock outstanding. Thus, if a personal service corporation has both common and preferred stock outstanding and the preferred shareholders are entitled to a specified dividend before any distribution may be made to the holders of the common stock, then the assumed distribution of the undistributed Supplement S net income must first be treated as a payment of the specified dividend on the preferred stock before any part may be allocated as a dividend on the common stock.

**13. Credit for interest on obligations of the United States and its instrumentalities.**—Each shareholder of a personal service corporation who as of the last day of the taxable year of the corporation is required to include in his gross income his proportionate share of the undistributed Supplement S net income of the corporation shall, for the purposes of the tax imposed by section 11 (normal income tax), section 13 (tax on corporations in general), section 201 (tax on life-insurance companies), section 204 (tax on insurance companies other than life or mutual) section 207 (tax on mutual insurance companies other than life or marine), or section 362 (tax on regulated investment companies), be allowed a credit against net income of his proportionate share of the interest specified in section 25(a) (1), interest on United States obligations, or section 25(a) (2), interest on obligations of instrumentalities of the United States (reduced by as much of the deduction under section 23(v) as is attributable to such share) which is included in the gross income of the corporation. However, see section 23(aa) with respect to optional standard deduction for individuals in lieu of certain deductions and credits.

**14. Effect on capital account of personal service corporation.**—If the undistributed Supplement S net income of a personal service corporation, or any portion thereof, for any taxable year is required to be included in the gross income of the shareholders, such undistributed Supplement S net income shall, for income tax and excess profits tax purposes, be treated as paid-in surplus or as a contribution to capital, paid in as of the close of such taxable year and the accumulated earnings and profits of the corporation shall be correspondingly reduced.

**15. Basis of stock in hands of shareholders.**—If a shareholder of a personal service corporation is required to include in his gross income his proportionate part of the undistributed Supplement S net income of the corporation, the amount so included shall, for the purpose of adjusting the basis of his stock with respect to such proportionate part, be treated as a distribution actually made by the corporation and as a reinvestment in the corporation by the shareholder. It shall, however, be so treated only to the extent to which such amount is included in the return of the shareholder, increased or decreased by any adjustment of such amount in the last determination of the tax liability of the shareholder made before the expiration of 7 years after the date prescribed by law for the filing of his return.

**16. Period of limitation on assessment and collection.**—For period of limitation on assessment and collection without assessment in the case of failure to include in gross income the amount properly includible therein under section 394(b), see section 275(d).