

Personal Service Corporation

Personal service corporations (PSC) are “C” corporations that are taxed by the IRS at a flat rate of 35% on net income.

A corporation qualifies as a personal service corporation if:

- The principal activity during the “testing period” for the current tax year is the performance of personal services (such as health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting), and
- Services are substantially performed by employee-owners who own more than 10% of the fair market value of the corporation’s stock as of the last day of the testing period for the current tax year.

The “testing period” for the current tax year is the PRECEDING tax year. (For a new corporation in its first tax year, the testing period is the period beginning on the first day of its first tax year and ending on the earlier of the last day of its first tax year or the last day of the calendar year in which the first tax year began).

Remedy

To avoid the “personal service corporation trap”, file an election with the IRS to become an “S” corporation, or, if there are two or more owners, form a limited liability company (LLC) rather than a “C” corporation.

