The Professional Corporation: How Section 269A Affects It

HENRY H. RAATAMA, JR. and SHARON QUINN DIXON
The Practical Accountant

Internal Revenue Code Sec. 269A is the IRS's newest weapon in its continuing battle against partnerships of professional corporations (often referred to as professional associations). How effective is this new weapon and what will be its impact on the professional corporation?

Before the enactment of Sec. 269A, the "partnership of professional corporations" form of doing business offered several advantages. Probably most important was the ability of the professional to participate as an employee in a corporate retirement plan, securing a substantially larger deduction for a contribution to the plan than if he or she participated in a Keogh plan. In addition, the professional had greater control in fashioning a total compensation package suited to his or her needs and enjoyed fringe benefits available only to a corporate employee. Corporate status also made possible the accumulation of income at the lower corporate rates and the selection of a fiscal year that provided tax deferral opportunities. In addition to these tax benefits, a professional in most states could limit personal liability to liability for his or her own acts. These and other reasons combined to make the partnership of professional corporations very attractive.

Section 269A is aimed at stripping such corporations of nearly all these tax benefits. The Congressional intent relative to Sec. 269A is expressed in the Conference Committee Report to TEFRA:

> The Conferees intend that the provisions overturn the results reached in cases like *Keller v.* [*Comm'r*, (77 TC 1014, *aff'd*, CA-10, 12/9/83)], where the corporation served no meaningful business purpose other than to secure tax benefits which would not otherwise be available (H.R. No. 760, 97th Cong., 2d Sess. 633 (1982).

TEFRA eliminates the disparity between corporate and Keogh plans, beginning in 1984, and Sec. 269A is intended to result in the reallocation to the shareholder-employee of the other tax benefits that historically made corporate status desirable. To make any conclusion as to whether this goal will be accomplished, it is first necessary to understand Sec. 269A and to determine whether, in a given situation, a corporation will meet the threshold test for its application.

How Professional Corporations Developed

The saga of the professional corporation probably began with the famous *Kintner* (216 F.2d 418) case, in which the Ninth

---

The authors are members of the law firm of Mershon, Sawyer, Johnston, Dunwody & Cole in Miami, Florida.

The Practical Accountant, Vol. 17, No. 1, pp. 34-44. **Subscription rates: $42.00 per year; $3.50 per copy.**

Circuit held that a partnership of doctors that acted like a corporation would be treated as such for federal income tax purposes. As a result of that case, the IRS, in regulations under Sec. 7701, provided that the taxability of an organization would be governed by its characterization under local law. Numerous states then enacted legislation enabling professionals to operate in corporate form, and many professionals incorporated.

Disturbed about this trend, the IRS then amended its Sec. 7701 regulations in 1965 to provide flatly that professional corporations could *not* be characterized as corporations for federal income tax purposes. However, these regulations were invalidated by various courts (see *Kurzner*, 413 F.2d 97). As a result, the IRS conceded its position in 1969 and stated that professional corporations would be treated as corporations.

The final phase of the professional corporation trend occurred in the 1970s and early 1980s when professionals began forming partnerships of professional corporations. This form of doing business had several important advantages, notably the ability to exclude certain employees from retirement plan coverage. The IRS's attacks on this form of business were generally unsuccessful, except in ususual situations. By enacting Sec. 269A, Congress came to the aid of the IRS.

The Key Elements

Section 269A is aimed at a "personal service corporation" in which "substantially all the services" are performed for one other entity and whose "principal purpose" is tax avoidance or evasion by securing certain "benefits which would not otherwise be available." If Sec. 269A applies, the income, deductions, credits, exclusions, etc. of the corporation may be reallocated among the corporation and its employee-owners.

Let's focus on each of these key phrases to see how Sec. 269A works.

"Personal Service Corporation"

Section 269A and the proposed regulations define "personal service corporation" as "a corporation the principal activity of which is the performance of personal services that are substantially performed by employee-owners" (Sec. 269A(b)(1); Prop. Reg. Sec. 1.269A-1(b)(1). This definition leaves unanswered the question of just what are "personal services."

TEFRA Sec. 247, which provides liquidation relief for "personal service" corporations subject to Sec. 269A, uses the definition of a personal service corporation provided by Sec. 535(c)(2)(B) (i.e., a corporation that performs services in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting). It does not, however, mention real estate agents or persons performing selling services, such as in the *Foglesong* case (TC Memo. 1976-294, *rev'd and rem'd*, 621 F.2d 865, *reheard at* 77 TC 1102, *rev'd and rem'd*, 691 F.2d 848). It therefore appears that the definition of a personal service corporation is much broader under Sec. 269A than under TEFRA Sec. 247 so that a corporation may be characterized as a personal service corporation for purposes of Sec. 269A but not for relief purposes under TEFRA Sec. 247. The IRS probably will attempt to bring within the meaning of personal service corporation any corporation like that in the *Keller* case (cited above) that takes advantage of certain tax benefits. This would include corporations that provide real estate services and selling services, if they otherwise meet the requirements of Sec. 269A, even though they do not come within the parameters of TEFRA Sec. 247.

"Substantially All Services"

Since the term "substantially all services" is not defined in Sec. 269A or in the proposed regulations, the question arises as to what is "substantially all" in connection with the services rendered by a personal service corporation. While no problem of interpretation exists as to the professional corporation

that is a partner and performs substantially all its services for the partnership, what about, for example, a medical professional corporation that performs services at one particular hospital for a variety of patients? One author has suggested that the 90% and 85% tests of Sec. 103 and 4942(j)(3), respectively, might be standards for purposes of applying Sec. 269A. However, these are very generous figures, and it is not unlikely that the IRS will apply a lower percentage threshold to determine the applicability of Sec. 269A. And aside from the question of the percentage threshold, would the percentage test be based on time spent or gross receipts or some other standard?

"Principal Purpose"

The "principal purpose" wording in Sec. 269A is nearly identical to the wording in Sec. 269, which allows the IRS to disallow certain deductions, etc., if a corporation is acquired for the principal purpose of avoiding federal income tax. Immediately raised is the issue of *the* "principal purpose" for forming or availing of a personal service corporation for purposes of Sec. 269A.

Section 269 will apply if the taxpayer's tax evasion or avoidance purpose in making an acquisition "exceeds in importance" all other purposes (Reg. Sec. 1.269-3(a)(2). The proposed regulations under Sec. 269A provide a much more objective test in determining the principal purpose. Proposed Reg. Sec. 1.269A-1(a)(2) states: "Such purpose is evidenced when use of the corporation either reduces the income of any employee-owner, or secures for any employee-owner one or more tax benefits which would not otherwise be available." Not surprising, the threshold of this test is obviously much less than the threshold of Sec. 269.

The proposed regulations, however, do provide a safe-harbor test, although this test is in terms of income tax *liability* not *income*. A personal service corporation will not meet the principal purpose test if the federal income tax liability of the owner for a 12-month period is reduced by no more than the *lesser* of (1) $2,500, or (2) 10% of the federal income tax liability for that 12-month period that would have resulted if the owner had performed the services in an individual capacity (Prop. Reg. Sec. 1.269A-1(c).

It is not clear what 12-month period is involved for purposes of this safe-harbor test. It appears that this 12-month period can cross the partnership's and the personal service corporation's fiscal years. Conspicuously absent from the regulation is the term "calendar year." The employee-owner must therefore take care to consider all applicable 12-month periods to determine if he or she meets the safe-harbor test.

"Tax Benefits Not Otherwise Available"

The Conference Committee Report states that Sec. 269A will apply if a personal service corporation is formed to avoid tax by securing significant tax benefits "which would not otherwise be available" to the employee-owner. Neither Sec. 269A nor the proposed regulations contain any "significant" tax benefit wording. The proposed regulations apparently translate "significant" tax benefits into "any" tax benefits that cause the owner to fail the safe-harbor test. According to the regulations, if the corporation enables the owner to secure "one or more" tax benefits that would not otherwise be available, Sec. 269A will apply. The proposed regulations include in the term "tax benefits" the whole panoply of corporate- and employee-type benefits except those available under a corporation's qualified employer plan in existence on or before September 3, 1982 (Prop. Reg. Sec. 1.269A-1(a)(2) and (b)(6).

A personal service corporation can make itself somewhat "clean" by not availing itself of most of the currently enjoyed tax benefits that will trigger the application of Sec. 269A. For example, the corporation can, with a minimum of adverse tax consequence, eliminate life insurance and accident and health plan benefits, give up multiple surtax exemptions, and stop accumulating income. However, ridding the corporation of prior accumulations of income and eliminating the effect of the deferral resulting from

different tax years (of the owner and the corporation) can be brought about only if the owner recognizes in one year much more income than he or she would recognize without the corporation, i.e., suffers a bunching of income in that year. This is only true, though, because such accumulations and deferral were permissible when made.

Admittedly, Sec. 269A is aimed at eliminating benefits that would otherwise not be available. But it seems unfair to penalize the employee-owner, who is otherwise attempting to comply with the law, by eliminating benefits that would otherwise have been unavailable (i.e., an after-the-fact reallocation). Unfair or not, personal service corporations and their employee-owners should not be surprised if the IRS claims that Sec. 269A applies to a "clean" corporation that has accumulated income and is on a fiscal year different from its employee-owner's. Each employee-owner must decide if he or she wants to risk reallocation when the corporation is "clean" except for income from accumulations and deferrals.

What Will Be Reallocated?

If Sec. 269A applies, the IRS may allocate *all* income, deductions, etc., to the shareholder if that is necessary to prevent the evasion of federal income tax or to clearly reflect the corporation's and/or the shareholder's income. The IRS's authority under Sec. 269A is very similar to its authority under Sec. 482. The Tax Court in the *Keller* (cited above), *Achiro* (77 TC 881), and *Pacella* (78 TC 604) cases held that Sec. 482 would not apply where the compensation reflected what the individual taxpayer would have received had he or she not incorporated (the corporations were "clean" at the time). While this logic should apply to the Sec. 269A situation, the IRS, viewing Sec. 269A as having been designed to eliminate *Keller*-type benefits, may ignore logic and adopt a position that the Tax Court has routinely refused to follow.

Congress' choice of wording for Sec. 269A is highly unusual in that it tracks that of Sec. 482. Yet, Congress knew that the courts had held that those words did not apply to the situation it sought to cover.

Section 269A is unlike Sec. 482 in that Sec. 269A specifically allows the IRS to reallocate *all* income, deductions, etc., whereas Sec. 482 does not use the word *all*. Implicit in Sec. 482 is the authority to reallocate all income tax items, but only if this is necessary to clearly reflect income. The IRS is given the authority in Sec. 269A to reallocate "all" income items if the threshold test is met, regardless of whether total reallocation is necessary to clearly reflect income. In fact, it would not be unexpected for the IRS to reallocate all income, etc., even if only one item fell within the prohibited purpose (and did not meet the safe-harbor test). For example, if a personal service corporation had investment income that would generate more tax if attributed to the individual than to the corporation, it would appear that the IRS could reallocate all items of income, not just the investment income. In effect, the IRS would be ignoring the corporation if it determined that Sec. 269A applied.

The Single C Corporation

One alternative to liquidating the personal service corporation is to merge individual partners' corporations to form a single corporation with each individual professional a shareholder thereof. In this way, the corporation could maintain employee fringe benefits without risking the application of Sec. 269A. However, this solution does not afford flexibility for each individual as to his compensation, fringe benefits, and pension package, one of the key advantages to the partnership-of-professional-corporations mode. While the professional would gain (or simply not lose) employee fringe benefits, he would do this at a cost of losing maximum compensation flexibility.

The S Corporation Alternative

One alternative that would seem not to be

subject to successful IRS attack under Sec. 269A is "S corporation" status (Sec. 1361(a)(1). An S corporation enables the professional partner who operates in corporate form to obtain much of the same flexibility in compensation design as would a regular corporation, regardless of the partnership's planning. By definition, there should be no tax benefit through avoidance, etc., if a personal service corporation is an S corporation.

Under the Subchapter S Revision Act of 1982 (SSRA), an S corporation will be treated as a partnership and a "more-than-2% shareholder" will be treated as a partner of such partnership for purposes of applying the Code provisions that "relate to employee fringe benefits" (Sec. 1372). For these purposes, a more-than-2% shareholder is any person who owns, either directly or through Sec. 318 attribution, on any day during the corporation's taxable year, more than 2% of the corporation's stock or voting power.

SSRA has, thus, eliminated a previously available advantage of subchapter S status, under which the owners were employees of the corporation and could take advantage of employee status for fringe benefit purposes. Because of parity, however, this does not present a problem in the future. By electing S corporation status, then, a personal service corporation's shareholder will not be able to utilize certain tax-favored fringe benefits, including group-term life insurance under Sec. 79, the death benefit exclusion of Sec. 101(b), the benefits of certain accident and health plans, and certain medical reimbursement plans under Secs. 105 and 106 (i.e., the benefits listed as tax benefits in the proposed regulations under Sec. 269A).

The most serious problem in this regard will be for existing corporations that elected fiscal years. The professional corporation on a fiscal year will be able to elect S corporation status only if the income deferral is three months or less (Rev. Proc. 83-25, IRB 1983-15).

If the corporation were to change its accounting period, unwinding the fiscal year would likely cause a bunching of previously deferred income.

The Committee Report to the SSRA suggests that the new law contemplated eliminating only medical and life insurance coverage, the death benefit exclusion, and the exclusion from income of meals or lodging furnished for the convenience of the employer, and should have no effect on the deductibility of qualified retirement plan contributions.

Despite the SSRA's changes in the fringe-benefit area, the shareholder of the personal service corporation would be in the same position (except for the $2,500 safe-harbor test) by electing S corporation status as he would be if Sec. 269A were held to apply to the subchapter C corporation through which he is taking advantage of employee fringe benefits. In fact, the certainty of subchapter S treatment is an advantage to the shareholder of a personal service corporation who may be wary of future IRS interpretations of Sec. 269A. Electing S corporation status is a good way to ensure that a personal service corporation will not use tax benefits to cause the application of Sec. 269A. Moreover, by maintaining separate entity status, the shareholder-employee of the personal service corporation that is a partner retains the corporate advantages of limited liability and being able to have a compensation package best suited to his or her needs.

The Liquidation Route

Despite the continuing advantages of retaining corporate status in a partnership, some employee-owners of personal service corporations may decide to throw in the towel. Perhaps they may not want to risk a Sec. 269A attack or they may feel that S corporation treatment is not the answer, or they may just believe that the extra expense and "hassles" of corporate existence outweigh the advantages. For such taxpayers, TEFRA Sec. 247, a temporary relief provision not incorporated into the Code, provides a painless out by allowing them to liquidate the corporation under Sec. 333 during 1983 and 1984 without gain or loss

recognition by the corporation on the distribution of unrealized receivables. However, the income represented by the unrealized receivables will retain its character as ordinary income and be fully recognized by the distributee-shareholder upon subsequent collection or other disposition.

TEFRA Sec. 247 defines unrealized receivables the same as does Sec. 751(c), which includes rights to payment for "services rendered or to be rendered" as unrealized receivables. TEFRA Sec. 247 further provides (1) that, for purposes of computing earnings and profits under Sec. 312, the liquidating corporation shall not treat unrealized receivables as an item of income and (2) that the determination of whether Sec. 333 applies will be made without regard to whether the corporation is a collapsible corporation under Sec. 341.

For a corporation that has been in existence for a sufficient length of time to accumulate earnings and profits, which would trigger dividend income to the shareholder in a Sec. 333 liquidation notwithstanding TEFRA Sec. 247, the decision to liquidate should be very carefully weighed. But for the many personal service corporations that were incorporated and became partners only within the last few years, E&P may not be a major concern as the corporation would probably have minimal earnings and profits.

Problems with TEFRA 247

The shareholder of a personal service corporation contemplating liquidation under TEFRA Sec. 247 must be advised that the provision does not eliminate taxes upon liquidation. For example, TEFRA Sec. 247 does not deal with the question of whether the corporation will recognize ordinary income with respect to depreciation recapture. Moreover, the amount of this potential depreciation recapture is not limited to the depreciation claimed by the personal service corporation, but may extend to depreciation claimed by the shareholder before incorporation if the depreciable property was transferred to the corporation in a Sec. 351 exchange.

The only asset of the personal service corporation often will be the partnership interest but the partnership will usually own depreciable property. Section 751(a)(1) provides for ordinary income treatment to a transferor partner who sells or exchanges for money or property his partnership interest attributable to unrealized receivables, which *includes* depreciable property. It is not certain whether distribution of a partnership interest in liquidation is a sale or exchange (or if the receipt of a corporation's own stock is property) but if it is, Sec. 751 may come into play to trigger ordinary income recapture to the corporation.

A liquidating corporation generally does not recognize gain upon liquidation under Sec. 336 and this non-recognition provision should be held to override the characterization provision of Sec. 751. But there is no clear authority for this, and personal service corporations that are partners in a partnership holding depreciable property should be advised that liquidation may trigger unexpected income.

TEFRA Sec. 247 also does not deal with investment tax credit recapture upon liquidation. Section 47(a) provides for ITC recapture if the property ceases to be Sec. 38 property with respect to the taxpayer before the close of the useful life which was taken into account in computing the credit. Section 47(b) provides, however, that recapture should not apply to "a mere change in the form of conducting the trade or business" as long as the taxpayer retains a substantial interest in such trade or business. Under Sec. 47(b), the ITC claimed by an individual partner before incorporation should not be recaptured when the partnership interest is distributed to the individual partner in liquidation.

On the other hand, ITC claimed by a partner is subject to recapture when his profits interest in the partnership is reduced by more than one third, unless he owns the partnership interest indirectly by ownership in another entity and the basis of the partnership interest to the entity is carried over from the individual partner. In any case, it is not

clear that this will be the IRS's position, and the owner-employee takes the risk of ITC recapture until the IRS announces otherwise.

If the personal service corporation were the partner when the Sec. 38 property was placed in service, the corporation would have taken the ITC — and, therefore, recapture of such ITC on liquidation would probably occur because there would not be a mere change in the form of conducting the business, as the corporation would not be in existence. Moreover, the shareholder's basis in the partnership interest would not be a carryover of the corporation's basis, further supporting the argument for recapture. It is much clearer that in this situation recapture of such ITC will occur upon liquidation unless the IRS states otherwise.

Liquidation of several corporate partners may also cause the partnership to terminate under Sec. (708)(b)(1)(B), which provides that a partnership will be considered terminated if there is a sale or exchange of more than 50% of the total interest in partnership capital and profits. As in the question of whether Sec. 751 will apply to cause depreciation capture, it is uncertain whether liquidation of the personal service corporation will constitute a sale or exchange of the partnership interest for this purpose. If it does, liquidating partners must be advised of the possibility and of the consequences of termination. The different shareholders should work out among themselves which partners should liquidate and how they collectively should deal with adverse consequences to certain individuals, should they occur.

Other Liquidations

Some personal service corporations subject to Sec. 269A may desire to liquidate under Sec. 331 rather than Sec. 333. Under Sec. 331, all gain realized by the shareholder distributee will be recognized and treated as received in exchange for his or her stock, most likely as capital gain. The corporation will have no protection under TEFRA Sec. 247 from the recognition of gain on the distribution of accounts receivable or against a collapsible corporation attack. If the corporation does not have a large amount of accounts receivable, this is not a problem. But problems associated with depreciation and ITC recapture and with termination of the partnership remain. Also, if the corporation does not have extensive accounts receivable, the possibility of capital gain treatment to the shareholder under Sec. 331 may outweigh the benefits of a Sec. 333 liquidation under TEFRA Sec. 247.

It has also been suggested that the employee-owner phase out his corporation. He could take over as an individual partner, allow the corporation to continue to collect any accounts receivable and liquidate the corporation after collection of the receivables. However, this later liquidation does not eliminate possible depreciation-recapture and partnership-termination problems and whether this technique may prove advantageous depends on the facts of each case.

The above discussion covered just a sampling of some of the problems that liquidation under TEFRA Sec. 247 may pose and the alternatives to such a liquidation. The particular circumstances of each personal service corporation will dictate the importance and relevance of these problems and alternatives. Only careful consideration of the consequences of liquidation will reveal whether liquidating the corporation or maintaining it as a C corporation or an S corporation is best.

Conclusion

This article has examined the application and effects of Sec. 269A, discussed the problem areas and explored the continued viability of partnerships of personal service corporations. Section 269A does not necessarily call for the liquidation of such corporations, though it obviously has curtailed the expanded use of this partnership form. In deciding the future course for their corporations, employee-owners will have to, as in any other transaction, weigh the tax cost of various alternatives as well as consider intangible factors, such as the risk of an IRS audit, before taking any action.

THE IRS'S WEAPONS AGAINST PERSONAL SERVICE CORPORATIONS

The IRS has been waging a losing battle against professional and personal service corporations since the early 1930s. Among the weapons it has used in this long battle are (1) the sham theory, (2) the assignment-of-income doctrine, (3) Sec. 482 and (4) Sec. 269. Now, Congress has fashioned for the IRS still another weapon — Sec. 269A — which was specifically designed to be used against personal service corporations. Only time will tell how effective it will be.

As to how the IRS has fared with its four older weapons, the following "battlefield account" should provide some insights.

The Sham Theory

The "sham" theory was used early on in *Fox* (37 BTA 271) and *Laughton* (40 BTA 101). The IRS argued that the corporation and the shareholder were so intimately enmeshed that the corporation was a sham, and should not be recognized for tax purposes; therefore, its income should be taxed to the shareholder. In 1943, the Supreme Court seemingly foreclosed the IRS's sham argument in *Moline Properties, Inc.* (319 U.S. 436), by stating that so long as there was a business purpose for forming the corporation or a business activity was carried on, the corporation would be treated as a *separate* taxable entity. A more recent Tax Court case, *Roubik* (53 TC 365) demonstrated that the sham argument has viability where corporate formalities are nearly entirely disregarded. There, the professional corporation was held to be a sham because, although organized for a valid purpose, the corporation never engaged in providing the services of the doctors, i.e., each individual doctor had separate personal employment, separate offices, and a separate accounting of his own income and expenses. (In essence, the *Roubik* situation was factually very weak.)

Assignment of Income

The IRS has also attacked personal service corporations using the assignment-of-income doctrine, i.e., that the employee-owner had assigned his right to receive income to the personal service corporation and is the "true earner"; therefore, the personal service income should be taxed to the individual rather than to the corporation.

The IRS lost this argument in the early *Fox* and *Laughton* cases and has generally lost it since (see *Keller*, cited above). Recently, in *Foglesong* (cit above) the Seventh Circuit held that the T. Court's finding that a personal service corporati was a viable taxable entity precluded the cou from disregarding the corporate form under t assignment-of-income doctrine.

Nevertheless, the assignment-of-income do trine may be effective where the facts favor t IRS. For example, in *Johnson* (CA-9, 1982), professional basketball player assigned his rig to income to unrelated corporations with whic he had contracted to be an employee. The baske ball teams refused to deal with these corporatior and he therefore executed an assignment of h employment contracts to the corporations. Sim larly, in *Brooks* (TC Memo. 1982-690), an insu ance salesman assigned commissions receive from insurance companies to his 50%-owne corporation. The court held that the commission were taxable to the salesman, not the corporation The *Johnson* and *Brooks* situations, which re semble the classic assignment-of-income case were also factually weak. Thus, they are ver much unlike the other cases involving persona service corporations.

Section 482

In more recent years the IRS has argued that Sec. 482 allows it to allocate income, deductions, etc., between or among the personal service corporation and its shareholders. The IRS has enjoyed some success with this argument.

For example, in *Borge* (405 F.2d 673), an entertainer incorporated to avoid a limitation on deductible losses and to offset losses in his poultry business against the income he generated as an entertainer. The court upheld the IRS's allocation to the entertainer of part of Borge's entertainment compensation paid to the corporation. Borge's corporation received income far in excess of the salary it paid to him. Also, Borge was required to personally guarantee his performance under contracts with the corporation.

In the later *Rubin* case (51 TC 251, *rev'd and rem'd*, 429 F.2d 650; *reheard at* 56 TC 1155, *aff'd per cur.*, 460 F.2d 1216), the Second Circuit similarly upheld the application of Sec. 482 and the reallocation of income to the employee-owner of a management services personal service corporation. The Tax Court, in its second opinion in *Rubin*, rejected the taxpayer's argument that Sec.

482 did not apply because there were not two businesses among which to allocate income.

In *Achiro* (cited above), two individuals formed a corporation to provide management services to two companies in which the individuals owned substantial interests and for which the individuals had worked personally before forming the corporation. The Tax Court held that Sec. 482 applied but that reallocation was not required because the payments to the corporation reflected arm's-length charges for management services.

In *Keller* (cited above), a pathologist formed a corporation primarily to take advantage of a pension plan and a medical reimbursement plan. The corporation then replaced Dr. Keller as the partner in a medical partnership. The Tax Court stated that Sec. 482 is to be very broadly interpreted and applied in a case like *Keller* because "the issue involves the allocation of income between two separate taxpaying entities which satisfy the dual business requirement." However, the Tax Court applied the "arm's-length" rationale of *Achiro* to the corporation and held that a Sec. 482 allocation was inappropriate because the total compensation, including salary, pension plan contributions and medical benefits, received by Dr. Keller from Keller, Inc. was equal to what he would have received without the organization of the corporation (i.e., what would have been bargained for in an arm's-length transaction).

In *Pacella* (cited above), involving a psychiatrist's professional corporation, the Tax Court applied the *Keller* rationale and held that, even though Sec. 482 applied, the Sec. 482 reallocation was improper because Dr. Pacella's compensation from the corporation reflected "rather closely" that which he would have received from an unrelated entity.

The most recent *Foglesong* case is directly opposite to the *Achiro*, *Keller*, and *Pacella* cases on the Sec. 482 issue. In *Foglesong*, the corporation paid Foglesong, a chemical engineer, substantially *less* than it received in commission income. The Tax Court relied on *Keller* in deciding that Sec. 482 applied to the situation but, unlike *Keller*, held that reallocation of income under Sec. 482 was proper. The Seventh Circuit disagreed with the Tax Court's expansive interpretation of Sec. 482 and held that an individual who works exclusively for his corporation may not have the income earned by it allocated to him under Sec. 482. In such a case, Sec. 482 will not apply because there are not "two or more organizations, trades or businesses" among which to reallocate income.

Section 269

The IRS also has applied Sec. 269 in an effort to deny deductions to personal service corporations. Section 269 provides that if any person acquires control of a corporation and the principal purpose of such acquisition is the evasion of income tax by securing the benefit of a deduction, credit, etc., which such person otherwise would not enjoy, the IRS may disallow such deduction, credit, etc.

The IRS successfully applied Sec. 269 in the *Borge* case (in addition to Sec. 482). However, in *Achiro*, the IRS's attempt to deny the management company's income, deductions, etc., under Sec. 269 was blunted. Acknowledging that the principal purpose for forming the management company was to gain tax benefits of a corporate retirement plan, the Tax Court held that the IRS could not allocate the corporation's income and deductions under the sham theory, the assignment-of-income doctrine, Sec. 482 or Sec. 269. It specifically held that the formation of a corporation for the principal purpose of securing the tax benefits of a retirement plan is not an evasion or avoidance of taxes.

The latest weapon in the arsenal against personal service corporations is Sec. 269A, which is aimed at partnerships of personal service corporations or, as they are more popularly known, professional associations. It is interesting that, had it been in effect in the years in question, Sec. 269A would not have applied to the *Foglesong* or *Achiro* situations because the corporation did not perform substantially all of its services for one other entity. The IRS presumably will continue to challenge corporations not subject to Sec. 269A under the sham corporation and assignment-of-income theories, and under Secs. 61, 269, and 482.