



These are excerpts from Social Security Administration internal policies (POMS) and comments on treatment. The comments are in red.

RS 02101.505 Corporation — Defined

In law, a corporation is an artificial person, created under the laws of the State which grants the papers of incorporation. It is a historic and legitimate business form that is interwoven in the fabric of the American economy and has been used for a multitude of legal and financial reasons as a method of conducting an enterprise. It consists of one or more natural persons united in one body and is empowered to act in a certain capacity or to transact business of some designated nature or form as an entity distinct from any of the individuals who compose it.

When the ownership of a corporation rests in a few persons or a few families, or within a family, the corporation is generally designated as a “close” or “family” corporation.

This is the standard definition of a corporation as used by the IRS. If a corporate structure is used, it would be a close or family corporation. This is as it was expected.

RS 02101.540 Use of Corporate Form To Secure Coverage

GENERAL

It is a well-established principle upheld by the courts that if a corporation is recognized as such under State law and it in fact operates a business in a bonafide manner, SSA may not disregard it despite the fact that it may have been formed with the view of securing coverage, altering the distribution of the business' income or for some other purpose related to the Social Security Act or the Internal Revenue Code.

Social Security realizes it must recognize corporations

If the facts establish that a properly organized corporation exists, that it operates the business as the owner and derives income, and that a claimant receives remuneration as an officer and/ or because of services for the corporation, it necessarily follows that the remuneration constitutes wages for employment. The fact that a corporate business consists only of renting property or making and holding other investments and that the business was previously conducted by the claimant individually or by members of his/her family, will not in itself preclude a finding of employment.

Finding that the business is a corporation will not, in many cases stop them from determining or recognizing wage employment income to the beneficiary.



Close or Family Corporations.— Questions may arise as to employment and/or wages in a claim or earnings discrepancy based on alleged earnings from a close or family corporation. For example, records may have been manipulated to show payment of wages in inflated amounts. Also, a business which owned real estate, securities or other holdings producing investment income may have been incorporated to obtain coverage, when, in fact, the corporation has not functioned as a business entity and is nothing more than a legal fiction, i.e., it has done nothing more than meet the requirements of the State for the formation of a corporation.

SSA's interest is such that it can not stop with the establishment of the corporate entity in fact or in law. Court precedent has well established SSA's right and duty to look beyond form to substance in evaluating the operations of a corporation as they affect any aspect of a claim for benefits. The following sections establish guidelines and criteria for use in identifying, developing and disposing of claims and earnings discrepancies involving questionable close or family corporations.

While Social Security realizes it must recognize corporations, the courts have allowed Social Security Administration (SSA) to look inside the corporate legal form to determine if, in substance the beneficiary is receiving benefit that would otherwise be considered NESE or wage employment. This would be items such as the corporation paying personal bills, or retaining capital that does not have a defined business purpose.

RS 02101.550 Evaluation of Evidence

The determination in the close or family corporation case must flow logically from the findings based on the evidence. Where the corporation unquestionably exists, functions, earns income, pays salary and where the remuneration is justifiable, the determination must be in accord with these findings. This is so despite the fact that coverage is thereby obtained. On the other hand, where the weight of evidence establishes that a corporation is nothing more than a legal fiction, without substance or function, or that its alleged income and distributions are unreasonable and unsubstantiated, the determination must also be in accord with these findings.

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In the final analysis, each case must be decided on its own merits. It is SSA's responsibility to obtain evidence in questionable cases sufficient to render a reasonable determination and to avoid a seemingly arbitrary or capricious decision. The three basic findings which must be made in these cases are



enumerated in [RS 02101.545A](#). The facts must support these findings, just as the findings must support the final determination.

RS 02101.555 Small Business Corporations

A. GENERAL

Subchapter S of the Internal Revenue Code permits certain small business corporations (called S Corporations) to elect not to be subject to Federal corporation income tax. (RS 01802.003 explains that shareholders of such a corporation are not engaged in a trade or business.) An S Corporation is in every respect a corporation. The only difference between S Corporation and others is liability for Federal corporate income tax. Each shareholder of the electing corporation on the last day of the corporation's taxable year must include on his/her individual tax return his/her prorata share of the annual corporate income whether such income is distributed or undistributed. The electing corporation, although not liable for corporate income tax, is required to file an informational return on Form 1120-S (U.S. Small Business Corporation Return of Income).

The purpose of this law is to aid and foster small business corporations. Rather than taxing the S Corporation, the individual shareholders are taxed similar to the way partnership earnings are taxed. In general, this treatment permits businesses to select the form of business organization desired without an additional tax burden.

B. CORPORATION ELIGIBILITY REQUIREMENTS

This law applies only to businesses that are legally incorporated. A corporation makes an election by filing a Form 2553 (Election of Small Business Corporation) with the District Director of Internal Revenue. To qualify, all shareholders must consent to the election and the corporation must meet certain requirements as to number of shareholders, class of stock, etc.

This tax election may be revoked if the owners of a majority of the shares votes to do so or if the corporation no longer meets the requirements for S status. Termination of the tax election does not terminate the corporate structure. However, it does mean that the corporation becomes subject to Federal corporate income tax in the same manner and extent as if an election had not been made.

An election made by the shareholders does not change the character of the corporation income. The income is still earned by the corporation. When the corporation carries on a trade or business, the individual shareholder will never have NESE from that trade or business. But, it is proper, and not unusual, for a shareholder to be an employee of the corporation and to be paid wages. Also,



from time to time, the shareholders may receive dividends payments on their investments. Dividends paid on captial investments are not earnings.

The sub S corporation treatment follows the IRS treatment and definition. From the IRS perspective, the sub S corporation is treated essentially in the same manner as a partnership except wages are paid to shareholders/employees and excess earnings are paid out or recognized as distributions or dividends. Form 1120s is filed for information purposes only. The income to the sub S corporation is considered to be NESE or unearned distributions or dividends for IRS purposes. Income is a pass-through, and all business income received to the business in a year must be passed through to the shareholders as wages or distributions and taxes are paid by the shareholders as individuals.

Questions may arise in connection with claims involving individuals who are shareholders in this type of corporation relating to the bona fides of the corporate entity and its operation. In general the approach set forth in [RS 02101.540-RS 02101.550](#) applies in resolving such questions. An election not to be subject to corporate taxes is not adequate grounds for questioning the bona fides.

Under this structure, the earnings could be paid to the individuals as dividends rather than wage earnings. It must be recognized that if the person is also an employee or officer working for the company, money received will generally be considered income from wage employment. I still have a problem reconciling the difference in treatment between the IRS and SSA with regard to sub S corporations. The information I have is that SSA will treat the income based on the value of services rather than the actual amount paid.

RS 02101.016 Officer of a Corporation

Citations:

Act as amended - Sec. [210\(j\)\(1\)](#)

Regulations No. 4 - Sec. [404.1006](#)

Generally, an officer of a corporation is an employee of the corporation. The officer is deemed to be in "employment" even though the officer does not perform any services for the corporation, provided the remuneration is received for holding corporate office. (See RS 01402.032 for the wage status of payments, other than vacation or sick pay, made to a corporate officer prior to 1/1/84 after the month of attainment of retirement age if the officer did not work for the corporation in the period for which the payment is made.) However, an officer of a corporation who as such does not perform any services or performs only minor services and who neither receives nor is entitled to receive, directly or indirectly,



any remuneration for serving as an officer is not considered to be an employee of the corporation.

Although an officer of a corporation is generally an employee, payments made to the officer do not constitute “wages” unless such payments are made for performing services for the corporation or for holding corporate office. Payments by a corporation to an officer for reasons other than the holding of a corporate office, for example, payment of dividends, repayment of loans, fees for services performed in other capacities of a nonemployment nature, etc., are not wages. Such payments are often made to “honorary” or inactive corporate officers.

As a corporate officer or shareholder, the individual could be paid dividends. For IRS purposes, this can only occur in a C corporation, however these sections of the POMS indicate that this would be acceptable for either a C or an S Corporation. If the individual is providing services to the corporation and receiving dividends, SSA can and has determined that the remuneration was wages. See the section on Evaluation of Evidence. Only true investment income would be counted as unearned income. (RS 02505.240 Summary of How Major Types of Remuneration Are Treated) There is an extensive questionnaire which SSA uses when dealing with corporate officers.

RS 02505.206 Corporate Officer Waives Salary

A. INTRODUCTION

Occasionally, an officer of a close/family corporation (or past officer who still appears to be in a position to control reported earnings) will waive all or part of the salary for his/her position. Also, that person does not remunerate himself or herself in the form of some other payments such as increased dividends, etc., for the fair value of the services rendered.

Waiving of compensation is allowed in certain circumstances.

In the ordinary case of a profitable business, the result of donating services; i.e., waiving salary, is to build up the profits of the corporation and avoid or reduce taxes. If these profits are not distributed, they build up the earned surplus.

Surpluses are only recognized in C corporations for IRS purposes.

A claimant is not required to accept a salary. This is a legitimate arrangement so long as salary is not hidden under labels of other kinds of income; i.e., is not available for the claimant's immediate use.

NOTE: The Internal Revenue Service (IRS) states in informational publications that an officer of the corporation (other than a director) must pay himself/herself a reasonable salary for work performed for purposes of the Federal Insurance Contribution Act (FICA). Sometimes, citing an IRS requirement will induce more cooperation.



B. POLICY — EARNED SURPLUS

How such earned surplus is treated under the earnings test is at the core of many QR cases. Treatment depends on a careful and prudent evaluation of all the facts in the case as explained in E. below and [RS 02505.218](#).

There are a number of examples in RS 02505.218 Illustrative QR Case Situations.

1. Availability of Funds

Finding Remuneration Greater than Alleged

It may be proper to find that an officer has, in effect, received earnings greater than alleged where the officer waiving salary is in a position of control and the availability of funds permits the officer to remunerate himself or herself for services at any time but the officer chooses not to do so.

It cannot just be held. If the officer controls funds available, SSA can allege effective earnings.

2. Distribution of Available Funds

a. When Not to Distribute Available Funds

Redistribution of such retained earnings (undistributed corporate profits) need not be considered where the beneficiary's statement establishes a legitimate business objective in building up the earned surplus; e.g., planned business expansion, replacement of equipment, etc.

There needs to be an identified business need for an officer waive the payment of wages.

b. When to Distribute Available Funds

On the other hand, where the beneficiary's statement is not so convincing, and based on a careful evaluation of all the facts, the adjudicator may determine that:

- **The funds are available to the beneficiary; and**
- **A buildup in corporate surplus and the alleged donation of services (in whole or in part) serves no legitimate corporate purpose; and**
- **The arrangement is solely to circumvent the ET.**

Key point. They can determine that there is not a true business need.

C. PROCEDURE — FUNDS AVAILABLE FOR USE

If the adjudicator determines that the funds are available for the beneficiary's use, do the following:

- Prepare an SD in accordance with [RS 02505.190](#); and



- Assign an equitable portion of the corporate profits as remuneration or salary for the services rendered by the working corporate officer beneficiary.

If they determine the need is not a true need, or can be satisfied in another way, they can allocate corporate income to the individual.

D. POLICY — CORPORATION LOSING MONEY

There may be exceptional situations in which a corporation is in financial difficulty by reason of recurring operating losses.

In such situations, the waiver of a salary by an officer may be legitimate and necessary.

However, it is unlikely that an individual will forgo a salary on a permanent or semi-permanent basis and this, in itself, is often an indication that there is some other form of hidden remuneration or deferred compensation involved.

You are allowed to waive salary if the corporation is losing money.

E. PROCEDURE — DECIDING STATUS

1. Determining True Status of Remuneration

To determine the true status of remuneration before deciding on the legitimacy of the salary waiver, do the following:

- Review the factors in [RS 02505.203](#);
- Ascertain whether any future payment is anticipated such as deferred salary, dividends, etc;
- Determine whether any undistributed profits, undeclared dividends, or increase in earned surplus have accrued since the proposed salary waiver; and
- Ask the beneficiary or other responsible officers in the business how and when the surplus or profit from the business will be used or disposed of.

2. Deferred Compensation

In deferred compensation cases, scrutinize a salary waiver which results in additional earnings, surplus, undistributed profits, cash on hand, or undeclared dividends as an indication that the officer merely intends to defer the compensation.

If the circumstances of a case are such that the adjudicator believes that the case should be reexamined after paying benefits for a period of time, control the claim with a diary.

Deferred compensation is a complicated area. Under IRS guidelines, if the individual has the right to determine when the money can be received, they



consider it to be “constructively received” and taxes must be paid. There must be an agreement and documentation that the officer does not have control or the ability to control the deferred compensation.

From this text I feel that SSA will judge the income to be received, even if there is a deferment agreement.

F. POLICY — WAIVING SALARY TO AVOID ET

If the adjudicator determines however, that the beneficiary is in a position of control and is waiving the salary solely to avoid ET, a reasonable redistribution of corporate profits to salary should be made.

RS 02505.203 Forms of Payments Other than Salary or Net Earnings From Self-Employment (NESE)

A. POLICY

Adjudicators must determine objectively whether the beneficiary is receiving remuneration for services indirectly, in the form of payments other than salary or NESE.

B. KINDS OF PAYMENTS

Some sources of possible remuneration are:

- A significant increase in dividends;
- Payment of a larger than usual salary or NESE to other family members;
- Excessive rents or loan repayments; and
- Unusual and unexplained expenses.

Key Points for unearned income. SSA will be looking at these points for any Sub S or Sub C corporation.

C. DESCRIPTION OF PAYMENTS

A description of sources of possible remuneration follows.

1. Increased Dividends

A significant increase in dividends over a comparable prior period may be a form of remuneration for performing services.

It is important to be especially alert to this if the working beneficiary is the principal owner of a subchapter S corporation since the profits of these corporations are reported as income by the individual shareholders. (See [RS 02505.208B.3.](#) and example 7 in [RS 02505.218](#) for further information.)



2. Increased Pay to Other Family Member

Payment of larger than reasonable salary or NESE to other family members can raise a question as to whether this is being used as a medium to compensate the beneficiary for rendering services.

LIMITATION: Where the other family member to whom the larger than reasonable payment was made works in the business, credible evidence must convincingly show that the earnings for this person are unreasonably high before concluding that part of such earnings belonged to the beneficiary. If reasonable, we would not be justified in finding that part belonged to the beneficiary even if such earnings were not previously reported for this other family member.

3. Rents, Loan Repayments

Excessive rents or “loan repayments” from the business on properties leased to it by the beneficiary may be remuneration for services rendered but under another label.

4. Unusual and Unexplained Expenses

Other unusual and not satisfactorily explained “expenses” of the business, especially at or near the time that the beneficiary applies for benefits as evidenced by a comparison of several prior years tax reports, may represent indirect remuneration for services rendered by the beneficiary to the business. Examples might be an exceptionally large increase in pension costs, employee benefit programs, travel, entertainment, meals, advertising, etc., especially when the beneficiary receives all or most of the payments covering these increased business expenses.

D. PROCEDURE

1. Requests for Evidence

In cases involving payment received in a medium other than salary or NESE, take the following actions:

- Tailor requests for supporting evidence to suit special situations;
- Exercise patience and prudent judgment;
- Be careful not to impugn the integrity or truthfulness of the beneficiary;
and
- Always provide helpful and courteous service.

2. Treating Evidence

Fully identify the evidence and its source on the special determination required by [RS 02505.190](#).



RS 02101.018 Director of a Corporation

The board of directors is the governing body of the corporation and therefore is not subject to control by the corporation. Thus, a director with respect to directorial services, for example, attending and participating in board meetings, is not an employee. Such services are deemed to be in self-employment. (See [RS01802.032](#).) A director who does work for the corporation, other than attending and participating in the meetings of the board of directors, may be an employee with respect to such work if it is nondirectorial in nature.

Directors fees are considered to be NESE to the director.

Attendance at, and participation in, the meetings of subordinate committees seldom creates an employment relationship because most of these committees are directorial in nature. Committees formed pursuant to Federal or State statute, corporate by-laws, or authority vested in the board of directors, are directorial in nature and it may be assumed in the absence of evidence to the contrary that the directors serving on such committees are not employees with respect to such service. This assumption applies whether the committee is composed entirely of directors or composed in part of directors and in part of nondirectors.

Where a director is a member of a committee engaged in nondirectorial services, for example, doing appraisal work for the corporation, and the services are subject to actual control by the board of directors, the director is an employee with respect to services on the committee.

They are not considered employees of the corporation unless they provide other services to the business which would not be considered consistent with their position as director.