
CitedTax

October 14, 2026

Internal Revenue Service
Independent Office of Appeals
c/o [Examination Office that issued Letter 525]
[Street Address]
[City, State ZIP]

Re: Protest of proposed changes in Letter 525 dated September 22, 2026; Form 1120-S, taxable year ended December 31, 2023; [Taxpayer Name], EIN [EIN]

Dear Appeals Officer,

1. Taxpayer information

- Taxpayer: [Taxpayer Name], an S corporation (dental practice), Tampa, Florida
- Address: [Street Address], Tampa, Florida [ZIP]
- Daytime telephone number: [Telephone]
- Employer identification number: [EIN]
- Sole shareholder: [Shareholder Name], [SSN], who files a joint Form 1040
- Representative: [Firm Name], [Credential], [Telephone], [Address]

This protest is submitted by the firm as the taxpayer's authorized representative. A Form 2848 for the Form 1120-S for the taxable year ended December 31, 2023 and for the shareholder's joint Form 1040 for the same year is enclosed or is already on file. The firm asks that all correspondence be directed to the representative at the address above.

2. Statement of appeal, letter identified, and tax periods

The taxpayer wants to appeal the proposed changes set out in Letter 525 dated September 22, 2026, with the accompanying Form 4549 and Form 886-A, to the Independent Office of Appeals. The tax period involved is the taxable year ended December 31, 2023 (Form 1120-S), together with the flow-through effect on the sole shareholder's joint Form 1040 for the same year. A copy of the letter showing the proposed changes is enclosed.

The proposed changes are the disallowance of \$86,000 of management fees, the recharacterization of \$40,000 of distributions to the shareholder as wages, and the disallowance of \$12,500 of meals and entertainment, producing proposed additional tax of \$31,200 and an accuracy-related penalty under section 6662 of \$6,240. The taxpayer disagrees with each of the three adjustments and with the penalty. This protest is submitted within the period stated in the 30-day letter, which the taxpayer understands to end October 22, 2026.

Because the examination is of a Form 1120-S, a written protest is required to obtain Appeals consideration in all S corporation cases, regardless of the dollar amount at issue (26 CFR § 601.106).

This submission is intended to contain each item that Publication 5 calls for: the taxpayer's name, address and daytime telephone number, the statement of the wish to appeal, a copy of the letter showing the proposed changes, the tax periods involved, a list of each disputed issue with the reasons for disagreement, the facts supporting the position on each issue, the law or authority relied on, and the penalties of perjury declaration.

If any part of this submission is treated as not complying with those requirements, the firm asks that it be returned with an opportunity to perfect it rather than treated as a failure to respond.

Item	Proposed amount	Taxpayer's position
Management fees to commonly owned C corporation	\$86,000 disallowed	Disagree in full
Distributions recharacterized as wages	\$40,000	Disagree as to amount
Meals and entertainment	\$12,500 disallowed	Disagree in part
Proposed additional tax (flow-through to Form 1040)	\$31,200	Disagree
Accuracy-related penalty, section 6662	\$6,240	Disagree in full

3. Issue one: disallowance of \$86,000 of management fees

Proposed adjustment. The examiner disallowed \$86,000 of management fees paid by the practice to a C corporation owned by the same shareholder, on the ground that the payments were not ordinary and necessary and were a disguised distribution to the shareholder.

Facts relied on. The management company employs the practice's billing and human resources staff. It charges the practice cost plus 8% under a written agreement signed in 2021. Comparable third-party practice-management fees run 6% to 10% of collections, so the contractual rate sits inside the observed market range.

Law and authority. Section 162(a) allows a deduction for the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business (26 U.S.C. § 162). Treas. Reg. 1.162-1 lists management expenses among the items treated as business expenses and requires that the expenditure be directly connected with or pertain to the taxpayer's trade or business; the firm's notes carry that regulation.

Billing and human resources functions are functions of the dental practice itself, and the payee company performs them with its own employees.

The firm notes for completeness that the practice and the management company are owned by the same sole shareholder, so section 267(b)(12) treats them as related persons and section 267(a)(2) defers a deduction for an accrued but unpaid amount until the year the amount is includible in the payee's gross income. The taxpayer's position is that the \$86,000 was paid in 2023, not merely accrued, and the firm will produce the payment records.

The characterization of the payment as a distribution would require a showing that it was made for the shareholder's benefit rather than for services proximately related to the practice's business, and the written agreement, the staff actually employed, and the market rate point the other way.

Conclusion. The taxpayer asks that the \$86,000 be allowed as an ordinary and necessary business expense of the practice for the taxable year ended December 31, 2023. The firm will provide the management company's cost base, the practice's 2023 collections, and the payment records, so that the cost plus 8% computation and its relation to the 6% to 10% range can be verified line by line.

No retrieved authority addresses comparability in a professional practice setting, and the taxpayer therefore rests this issue on the documentary record rather than on any asserted case law.

4. Issue two: recharacterization of \$40,000 of distributions as wages

Proposed adjustment. The examiner recharacterized \$40,000 of distributions to the sole shareholder as wages subject to employment tax, on the ground that his reported salary of \$60,000 was unreasonably low.

Facts relied on. The shareholder works 50 hours a week as the practice's only dentist and was paid a salary of \$60,000 for 2023. Compensation surveys put a Tampa general dentist at \$180,000 to \$240,000. The taxpayer's position is that the survey range must be applied to this shareholder's actual hours and actual functions, and that amounts distributed above reasonable compensation for those services are a return on the capital invested in the practice.

Law and authority. An officer of a corporation is an employee of the corporation, but an officer who performs no services or only minor services and who neither receives nor is entitled to receive any remuneration is not an employee (26 CFR § 31.3121(d)-1). The taxpayer does not dispute that the shareholder performs substantial services and received remuneration, so that narrow exception does not apply to him.

The regulation fixes status only; it does not state a measure of reasonable compensation and does not state a rule authorizing the recharacterization of a stated distribution as remuneration.

The taxpayer's position that the proposed \$40,000 is overstated, and that the excess is a return on capital, is not supported by any authority retrieved for this protest and is presented here as a factual and valuation contention pending the firm's completion of its research into the reasonable-compensation case law and the Service's own guidance.

Section 1368 and the regulations under it govern how an actual distribution with respect to stock is applied against the accumulated adjustments account, earnings and profits and stock basis, and the firm will address those figures separately if any amount remains characterized as a distribution. The taxpayer asks that the examiner identify the authority and the comparability data relied on in setting the \$40,000 figure.

Conclusion. The taxpayer asks Appeals to reduce the wage recharacterization to an amount that reflects the shareholder's actual service hours and functions, supported by the survey data and by the practice's records of his non-clinical time. The taxpayer does not ask Appeals to find that no part of the distributions is remuneration. The firm will supply the hours records, the total 2023 distributions, the capital invested, and the accumulated adjustments account and basis figures.

5. Issue three: disallowance of \$12,500 of meals and entertainment

Proposed adjustment. The examiner disallowed \$12,500 of claimed meals and entertainment for 2023.

Law and authority. For amounts paid or incurred after December 31, 2017, the deduction for a qualifying food or beverage expense may not exceed 50 percent of the amount that otherwise would be allowable, and the expense qualifies only if it is not lavish or extravagant under the circumstances, the taxpayer or an employee of

the taxpayer is present at the furnishing, and the food or beverages are provided to the taxpayer or a business associate (26 CFR § 1.274-12).

The same regulation applies the substantiation requirements of section 274(d) to travel meals as to amount, time, place, business purpose and the business relationship of the person receiving the benefit (26 CFR § 1.274-12).

The firm notes that the former "directly related to" and "associated with" tests of section 274(a) were repealed for amounts paid or incurred after December 31, 2017, so for 2023 entertainment is not deductible unless one of the exceptions in section 274(e) applies. Where food or beverages are provided during or at an entertainment activity, the food and beverage portion is treated separately only if it was purchased separately from the entertainment or stated separately on a bill, invoice or receipt. The firm's notes carry those provisions, and the firm will confirm them before the conference.

Facts relied on and conclusion. The taxpayer's position is that the items in the \$12,500 that are business meals are allowable at 50 percent, and the taxpayer does not contend that any entertainment component is allowable. The facts presently available to the firm do not divide the \$12,500 between meals and entertainment, do not identify the attendees or the business purpose of each item, and do not confirm what limitation was already applied on the filed Form 1120-S.

The taxpayer will produce the contemporaneous records and a schedule dividing the \$12,500 by item, and asks that the allowable business meals then be allowed at 50 percent.

6. The accuracy-related penalty of \$6,240

Proposed adjustment. The examiner proposed an accuracy-related penalty under section 6662 of \$6,240 on the underpayment attributable to the three adjustments above. The Letter 525 and Form 886-A should state which subsection of section 6662 is asserted, and the taxpayer asks Appeals to identify it so that the correct defenses can be matched to the correct portion of any underpayment.

No penalty shall be imposed under section 6662 or 6663 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion (26 U.S.C. § 6664). The regulations under that section make this an all facts and circumstances inquiry in which the most important factor is the extent of the taxpayer's effort to assess the proper tax liability.

The taxpayer's effort is evidenced by the written 2021 management agreement, by the cost plus 8% rate set inside the documented 6% to 10% market range for third-party practice-management fees, and by the use of compensation surveys showing a Tampa general dentist at \$180,000 to \$240,000.

Reliance on a competent return preparer can satisfy the reasonable cause and good faith standard where the preparer was qualified, was given complete and accurate information, and the taxpayer actually relied in good faith on the preparer's judgment. The firm will identify the preparer of the 2023 Form 1120-S and the shareholder's Form 1040, the information furnished, and any written advice, and will present that evidence at the conference.

The statutory exceptions to the reasonable cause defense, for underpayments attributable to transactions lacking economic substance and for certain charitable deduction valuation items, are not in issue on these facts (26 U.S.C. § 6664).

If the penalty is asserted as a substantial understatement penalty, section 6662(d)(1)(A) requires that the understatement exceed the greater of 10 percent of the tax required to be shown on the return or \$5,000. The facts available to the firm do not state the total tax required to be shown on the shareholder's 2023 joint Form 1040, so that computation remains open and the taxpayer reserves it.

Section 6662(d)(2)(B) further removes from the understatement any portion attributable to an item supported by substantial authority, or adequately disclosed on the return or an attached statement where there is a reasonable basis; the firm will confirm whether any disclosure statement was filed with the 2023 returns. That reduction reaches the substantial understatement component only and not a negligence determination, and the firm's notes carry those provisions.

The taxpayer also raises the written supervisory approval requirement of section 6751(b)(1), which bars assessment of a penalty unless the initial determination of the assessment was personally approved in writing by the immediate supervisor of the individual making it. The taxpayer requests production of the Civil Penalty Approval Form and the Form 9984 case activity record for this examination.

Conclusion: the taxpayer asks that the \$6,240 penalty be conceded, and, at a minimum, that it be removed from each portion of any underpayment shown to rest on reasonable cause and good faith.

7. Request for an Appeals conference

The taxpayer requests a conference with the Independent Office of Appeals, by telephone or by video at the Appeals officer's convenience, and asks to be given at least 30 days' notice of the date so that the representative and the shareholder can both attend. The taxpayer is prepared to produce the written 2021 management agreement, the payment records, collections data, hours records, compensation survey materials, and the meals and entertainment schedule and receipts in advance of the conference.

A small case request would not suffice here. A written protest is required to obtain Appeals consideration in all S corporation cases regardless of the dollar amount at issue (26 CFR § 601.106), and in any event the proposed change for 2023 is \$31,200 of tax plus \$6,240 of penalty, which is \$37,440 in total and so exceeds the \$25,000 ceiling that Publication 5 sets for the small case request route.

8. Tax Court petition (a separate filing on its own 90-day clock)

No notice of deficiency has been issued on these facts. The Letter 525 dated September 22, 2026 is a 30-day letter and does not start any Tax Court period. This section is included so that the taxpayer's position is on the record and the deadline is understood if a notice is later issued.

Within 90 days, or 150 days if the notice is addressed to a person outside the United States, after a notice of deficiency authorized in section 6212 is mailed, not counting a Saturday, Sunday, or a legal holiday in the District of Columbia as the last day, the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency (26 U.S.C. § 6213).

That petition is a separate document filed with the Tax Court, and the period runs regardless of whether Appeals is still considering the case; a petition filed on or before the last date the Service specifies in the notice is treated as timely (26 U.S.C. § 6213).

While the period runs, and if a petition is filed until the Tax Court decision becomes final, the deficiency may not be assessed and no levy or collection proceeding may be begun for it, subject to the exceptions in sections 6851, 6852 and 6861; if no petition is filed, the deficiency is assessed and is payable on notice and demand (26

U.S.C. § 6213).

The deadline cannot be computed from the facts now available because no notice of deficiency has been mailed. If a notice is issued, the deadline is [notice mailing date] plus 90 days, or plus 150 days if the notice is addressed to a person outside the United States, and the firm will compute and docket the exact date from the notice itself. The taxpayer should not sign any waiver of the restrictions on assessment, such as a Form 4549 consent, without first considering the effect on this route.

The assignments of error and the facts relied on, if a petition becomes necessary, are these, stated in numbered paragraphs.

- 1. The Commissioner erred in disallowing \$86,000 of management fees paid by the practice in carrying on its trade or business for services actually rendered by the payee's employees under a written agreement signed in 2021 at a cost plus 8% rate within the 6% to 10% third-party market range.
- 2. The Commissioner erred in characterizing those management fees as a distribution to the shareholder rather than as payment for services provided to the practice.
- 3. The Commissioner erred in determining that \$40,000 of distributions to the shareholder constitutes additional wages, the amount being overstated when the compensation survey range of \$180,000 to \$240,000 is applied to the shareholder's actual hours and functions and the remainder is a return on capital.
- 4. The Commissioner erred in disallowing in full \$12,500 of meals and entertainment, to the extent that items within that amount are business meals allowable at 50 percent.
- 5. The Commissioner erred in determining an accuracy-related penalty under section 6662 of \$6,240, because the taxpayer had reasonable cause and acted in good faith with respect to each portion of any underpayment.
- 6. Facts relied on: the practice is an S corporation operating a dental office in Tampa, Florida, which filed Form 1120-S for the taxable year ended December 31, 2023; the sole shareholder files a joint Form 1040; the management company owned by the same shareholder employs the practice's billing and human resources staff and charges cost plus 8% under a written agreement signed in 2021; comparable third-party practice-management fees run 6% to 10% of collections; the shareholder works 50 hours a week as the sole dentist and was paid a salary of \$60,000 for 2023; compensation surveys put a Tampa general dentist at \$180,000 to \$240,000.

On the small tax case election, section 7463(a)(1) permits the procedure at the taxpayer's option, concurred in by the Tax Court before the hearing, where the amount of the deficiency placed in dispute does not exceed \$50,000 for any one taxable year. The proposed tax of \$31,200 plus the \$6,240 penalty is \$37,440 for 2023, which is below that figure as the statute currently reads, so the election would appear to be available if the notice determines the same amounts.

A decision entered under that procedure is not reviewable in any other court and is not treated as precedent, and the taxpayer has not yet decided whether to elect it; the firm will take instructions when the notice, if any, is in hand.

9. Declarations

For the taxpayer: Under penalties of perjury, I declare that I examined the facts stated in this protest, including any accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete.

Signature: _____ [Shareholder Name], [Title] of [Taxpayer Name] Date: _____

For the representative: I declare that I prepared this protest and any accompanying documents, and that I [do / do not] have personal knowledge that the facts stated in this protest and any accompanying documents are true and correct.

Signature: _____ [Name], [Credential], [Firm Name] Date: _____

10. Documents enclosed

Enclosures

1. Form 2848, Power of Attorney and Declaration of Representative, for Form 1120-S (2023) and Form 1040 (2023) [placeholder]
2. Copy of Letter 525 dated September 22, 2026
3. Copy of Form 4549, Report of Income Tax Examination Changes
4. Copy of Form 886-A, Explanation of Items
5. Management services agreement signed in 2021 [placeholder]
6. Schedule of management fee payments for 2023 with supporting records [placeholder]
7. Compensation survey materials for a Tampa general dentist [placeholder]
8. Schedule dividing the \$12,500 of claimed meals and entertainment by item, with receipts [placeholder]

For the firm before sending (remove this section)

Positions that did not pass the citation gate, positions to confirm, and facts the filing still needs:

- Needed: The exact response date printed on the Letter 525, and the mailing address or fax destination stated in that letter for the protest.
- Needed: Whether a Form 2848 covering the 2023 Form 1120-S and the shareholder's 2023 joint Form 1040 is already on file, and the shareholder's corporate office and authority to sign for the S corporation.
- Needed: Whether the \$86,000 of management fees was actually paid in 2023 or only accrued, and each entity's method of accounting (relevant to section 162 timing and to section 267(a)(2)).
- Needed: The management company's 2023 cost base, so that the cost plus 8% computation can be tied to \$86,000.
- Needed: The practice's 2023 collections, so that the \$86,000 can be expressed as a percentage and compared to the 6% to 10% market range.
- Needed: Whether the services actually rendered in 2023 match the scope described in the 2021 written agreement.
- Needed: The shareholder's corporate office, total 2023 distributions, clinical and non-clinical hours, the practice's 2023 net income, and the capital invested in the practice.

- Needed: The corporation's accumulated adjustments account, accumulated earnings and profits, and the shareholder's stock basis for 2023.
- Needed: The retrieved authority that measures reasonable compensation for a shareholder-employee; none was retrieved, and this element of the position is presently unsupported.
- Needed: The division of the \$12,500 between meals and entertainment, the attendees of each item, the business purpose of each item, and whether contemporaneous records exist.
- Needed: The limitation already applied to meals on the filed 2023 Form 1120-S, so that the amount actually in dispute can be stated.
- Needed: Which subsection of section 6662 the Service asserts (negligence under section 6662(b)(1) or substantial understatement under section 6662(b)(2)).
- Needed: The total tax required to be shown on the shareholder's 2023 joint Form 1040, needed for the greater of 10 percent or \$5,000 test in section 6662(d)(1)(A).
- Needed: Who prepared the 2023 Form 1120-S and Form 1040, what information that person was given, whether any written advice or contemporaneous compensation study exists, and the shareholder's own tax knowledge and experience.
- Needed: Whether any Form 8275 or other disclosure statement was filed with the 2023 returns.
- Needed: Whether written supervisory approval of the initial penalty determination was obtained under section 6751(b)(1), and on what date.
- Needed: The current Publication 5 figures and the current section 7463(a) jurisdictional amount, to be confirmed against the published text before filing.
- Needed: Firm name, representative name and credential, taxpayer name, address, EIN, SSN and telephone number.

Sincerely,

[Name], [Credential]

Authorities cited in this letter

26 CFR § 601.106 Regulation

• VERIFIED

"A written protest is required to obtain Appeals consideration in all partnership and S corporation cases."

IRS Publication 5 IRS publication

• CPA TO CONFIRM

Corroborating authority; not independently text-checked for this letter.

26 CFR § 601.105 Regulation

• CPA TO CONFIRM

Corroborating authority; not independently text-checked for this letter.

26 U.S.C. § 6213 Statute

• VERIFIED

"Within 90 days, or 150 days if the notice is addressed to a person outside the United States, after the notice of deficiency authorized in section 6212 is mailed (not counting Saturday, Sunday, or a legal holiday in the District of Columbia as the last day), the taxpayer may file a petition with the Tax Court for a redetermination of the deficiency."

26 U.S.C. § 7463 Statute

• CPA TO CONFIRM

Corroborating authority; not independently text-checked for this letter.

26 CFR § 301.6213-1 Regulation

• CPA TO CONFIRM

Corroborating authority; not independently text-checked for this letter.

26 U.S.C. § 6664 Statute

• VERIFIED

"No penalty shall be imposed under section 6662 or 6663 with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion."

26 U.S.C. § 6662 Statute

• CPA TO CONFIRM

Corroborating authority; not independently text-checked for this letter.

Estate of Thomas H. Fry, Ruth M. Fry, Personal Representative, and Ruth M. Fry (United States Tax Court, 2024-01-23)

• CPA TO CONFIRM

Court decision

Corroborating authority; not independently text-checked for this letter.

26 U.S.C. § 162 Statute

• VERIFIED

"There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business"

26 CFR § 1.162-1 Regulation

• CPA TO CONFIRM

Corroborating authority; not independently text-checked for this letter.

26 U.S.C. § 267 Statute

• CPA TO CONFIRM

Corroborating authority; not independently text-checked for this letter.

26 CFR § 31.3121(d)-1 Regulation

• VERIFIED

"Generally, an officer of a corporation is an employee of the corporation. 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 is considered not to be an employee of the corporation."

26 U.S.C. § 3121 Statute

• CPA TO CONFIRM

Corroborating authority; not independently text-checked for this letter.

26 U.S.C. § 3401 Statute

• CPA TO CONFIRM

Corroborating authority; not independently text-checked for this letter.

26 CFR § 1.274-12 Regulation

• VERIFIED

"Except as provided in this section, the amount allowable as a deduction for any food or beverage expense described in paragraph (a)(1) of this section may not exceed 50 percent of the amount of the expense that otherwise would be allowable."

Notice 2018-76, 2018-42 I.R.B. IRS notice

Corroborating authority; not independently text-checked for this letter.

• CPA TO CONFIRM

IRB 2020-12 Internal Revenue Bulletin item

Corroborating authority; not independently text-checked for this letter.

• CPA TO CONFIRM

26 CFR § 1.6664-4 Regulation

Corroborating authority; not independently text-checked for this letter.

• CPA TO CONFIRM

Draft prepared for the signing professional's review. Verify every fact and figure, complete the placeholders, attach the enclosures listed, and remove the section headed "For the firm" before filing.