South-Western Federal Taxation 2017 Corporations Partnerships Estates and Trusts 40th edition Hoffman Test Bank

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Chapter 02 Corporations Introduction and Operating Rules

1. Tomas owns a sole proprietorship, and Lucy is the sole shareholder of a C corporation. In the current year both businesses make a net profit of $60,000. Neither business distributes any funds to the owners in the year. For the current year, Tomas must report $60,000 of income on his individual tax return, but Lucy is not required to report any income from the corporation on her individual tax return.

a. True

b. False

ANSWER:	True
RATIONALE:	Proprietorship profits flow through to the owner and are reported on the owner's individual income tax return. It does not matter how much of the profit is withdrawn from the proprietorship. Thus, Tomas must report the net profit of $60,000 on his Form 1040 (Schedule C). Shareholders are required to report income from a C corporation only to the extent of dividends received. Consequently, Lucy has no income to report from the corporation for the current year.
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Application
OTHER:	Time: 2 min.

2. Carol and Candace are equal partners in Peach Partnership. In the current year, Peach had a net profit of $75,000 ($250,000 gross income – $175,000 operating expenses) and distributed $25,000 to each partner. Peach must pay tax on $75,000 of income.

a. True

b. False

ANSWER:	False
RATIONALE:	A partnership is not a taxpaying entity. Its profit (loss) and separate items flow through to the partners. The partnership's Form 1065 reports net profit of $75,000. Carol and Candace both receive a Schedule K-1 reporting net profit of $37,500. Each partner reports net profit of $37,500 on her own return (Form 1040).
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Application
OTHER:	Time: 2 min.

3. Rajib is the sole shareholder of Robin Corporation, a calendar year S corporation. Robin earned net profit of $350,000 ($520,000 gross income – $170,000 operating expenses) and distributed $80,000 to Rajib. Rajib must report Robin Corporation profit of $350,000 on his Federal income tax return.

a. True

b. False

ANSWER:	True
RATIONALE:	Similar to partnerships, the net profit or loss of an S corporation flows through to the shareholders to be reported on their individual tax returns. Robin's net income of $350,000 is allocated entirely to Rajib, as the sole shareholder, and Rajib reports the $350,000 of income

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on his Federal income tax return, regardless of how much of the income was withdrawn from the S corporation.

POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Application
OTHER: Time: 2 min.

4. Donald owns a 45% interest in a partnership that earned $130,000 in the current year. He also owns 45% of the stock in a C corporation that earned $130,000 during the year. Donald received $20,000 in distributions from each of the two entities during the year. With respect to this information, Donald must report $78,500 of income on his individual income tax return for the year.

a. True
b. False

ANSWER: True
RATIONALE: On his individual income tax return for the year, Donald must report his $58,500 ($130,000 × 45%) share of the partnership income plus the $20,000 of dividends he received from the C corporation, or $78,500 of total income. Partnership income is taxed to a partner in the year earned, and distributions do not affect a partner's share of income. A C corporation's income is taxed to a shareholder only when distributed as dividends and to the extent thereof.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Application
OTHER: Time: 2 min.

5. Quail Corporation is a C corporation with net income of $125,000 during the current year. If Quail paid dividends of $25,000 to its shareholders, the corporation must pay tax on $100,000 of net income. Shareholders must report the $25,000 of dividends as income.

a. True
b. False

ANSWER: False
RATIONALE: Quail Corporation must pay tax on the $125,000 of corporate net income. Dividends paid are not deductible by the corporation. Shareholders must pay tax on the $25,000 of dividends received from the corporation. This is commonly referred to as double taxation.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
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6. Eagle Company, a partnership, had a short-term capital loss of $10,000 during the year. Aaron, who owns 25% of Eagle, will report $2,500 of Eagle's short-term capital loss on his individual tax return.

a. True

b. False

ANSWER:	True
RATIONALE:	Capital losses of a partnership pass through to the partners and are reported on such partners' tax returns.
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Application
OTHER:	Time: 2 min.

7. Don, the sole shareholder of Pastel Corporation (a C corporation), has the corporation pay him a salary of $600,000 in the current year. The Tax Court has held that $200,000 represents unreasonable compensation. Don must report a salary of $400,000 and a dividend of $200,000 on his individual tax return.

a. True

b. False

ANSWER:	True
RATIONALE:	To the extent a salary paid to a shareholder/employee is considered reasonable, the corporation is allowed a salary deduction, which reduces corporate taxable income. To the extent a salary payment is not considered reasonable, the payment is treated as a dividend, which does not reduce corporate taxable income. The shareholder/employee is taxed on both salary ($400,000) and dividends ($200,000). (Pastel's taxable income increases by $200,000, the amount of the unreasonable compensation paid to Don.)
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS:	Bloom's: Comprehension
OTHER:	Time: 2 min.

8. Double taxation of corporate income results because dividend distributions are included in a shareholder's gross income but are not deductible by the corporation.

a. True

b. False

ANSWER:	True
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
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KEYWORDS: Bloom's: Comprehension
OTHER: Time: 2 min.

9. Jake, the sole shareholder of Peach Corporation, a C corporation, has the corporation pay him $100,000. For income tax purposes, Jake would prefer to have the payment treated as dividend instead of salary.

a. True
b. False

ANSWER: True
RATIONALE: Jake must include in gross income both salary and dividends, but he would prefer dividend income due to the preferential tax rate accorded such income.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 2 min.

10. Thrush Corporation files Form 1120, which reports taxable income of $200,000. The corporation's tax is $56,250.

a. True
b. False

ANSWER: False
RATIONALE: The tax is equal to $61,250 [($50,000 × 15%) + ($25,000 × 25%) + ($25,000 × 34%) + ($100,000 × 39%)].
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 2 min.

11. The corporate marginal income tax rates range from 15% to 39%, while the individual marginal income tax rates range from 10% to 39.6%.

a. True
b. False

ANSWER: True
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS: United States - BUSPORG: Analytic
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KEYWORDS: Bloom's: Knowledge
OTHER: Time: 2 min.

12. Employment taxes apply to all entity forms of operating a business. As a result, employment taxes are a neutral factor in selecting the most tax effective form of operating a business.

a. True
b. False

ANSWER: False
RATIONALE: Employment taxes applicable to payments to owners of businesses are not neutral in the selection of a business form. The self-employment tax applies to the net earnings of a proprietorship and, often, to partnership allocations of income to a partner. Individuals can deduct one-half of the self-employment tax paid. Conversely, payroll taxes (employer and employee) apply to wages paid to a shareholder-employee of a corporation (regular or S), and the corporation can deduct the employer share of payroll taxes paid. Any analysis of the most tax effective form of operating a business must consider these differences in the treatment of employment taxes.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 2 min.

13. Under the “check-the-box” Regulations, a two-owner LLC that fails to elect to be to treated as a corporation will be taxed as a sole proprietorship.

a. True
b. False

ANSWER: False
RATIONALE: Partnership is the default classification for a two-owner LLC that does not elect to be treated as a corporation under the “check-the-box” Regulations.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 2 min.

14. A personal service corporation must use a calendar year, and is not permitted to use a fiscal year.

a. True
b. False

ANSWER: False
RATIONALE: As a general rule, a personal service corporation (PSC) must use a calendar year. However, under certain circumstances (e.g., business purpose exception, § 444 election) a PSC may use a fiscal year.
POINTS: 1

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DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 2 min.

15. As a general rule, C corporations must use the cash method of accounting. However, under several exceptions to this rule (e.g., average annual gross receipts of $5 million or less for the most recent 3-year period), a C corporation can use the accrual method.

a. True
b. False

ANSWER: False
RATIONALE: The opposite is true. As a general rule, C corporations must use the *accrual* method of accounting. However, under several exceptions to the rule (e.g., average annual gross receipts of $5 million or less for the most recent 3-year period), a C corporation can use the cash method.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 2 min.

16. On December 31, 2016, Lavender, Inc., an accrual basis C corporation, accrues a $50,000 bonus to Barry, its vice president and a 40% shareholder. Lavender pays the bonus to Barry, who is a cash basis taxpayer, on March 14, 2017. Lavender can deduct the bonus in 2017, the year in which it is included in Barry's gross income.

a. True
b. False

ANSWER: False
RATIONALE: Because Barry is not a related party (more than 50% shareholder), Lavender's deduction for the bonus occurs in 2016, the year in which the $50,000 is incurred and accrued.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 2 min.

17. Azure Corporation, a C corporation, had a long-term capital gain of $50,000 in the current year. The maximum amount of tax applicable to the capital gain is $7,500 ($50,000 × 15%).

a. True
b. False

ANSWER: False

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RATIONALE:	While the maximum rate on long-term capital gains of individuals is generally limited to 15% or 20%, there is no tax rate preference applicable to long-term capital gains of C corporations. Thus, the maximum amount of tax applicable to Azure Corporation's capital gain is $19,500 [$50,000 × 39% (highest marginal rate)].
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS:	Bloom's: Knowledge
OTHER:	Time: 2 min.

18. Albatross, a C corporation, had $140,000 net income from operations and a $25,000 short-term capital loss in the current year. Albatross Corporation's taxable income is $140,000.

a. True

b. False

ANSWER:	True
RATIONALE:	A corporation cannot deduct a net capital loss in the year incurred; thus, Albatross has taxable income of $140,000. For corporations, a net capital loss must be carried back three years and forward five years and be offset against capital gains in the carryback/forward years.
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS:	Bloom's: Comprehension
OTHER:	Time: 2 min.

19. If a C corporation uses straight-line depreciation on real estate (§ 1250 property), no portion of a recognized gain on the sale of the property will be recaptured as ordinary income.

a. True

b. False

ANSWER:	False
RATIONALE:	Section 291 requires the recapture of some depreciation for corporate taxpayers on the sale of § 1250 property for a gain, even if straight-line depreciation had been claimed on the property.
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
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20. The passive loss rules apply to closely held C corporations and to personal service corporations but not to S corporations.

a. True

b. False

ANSWER: True

RATIONALE: The passive loss rules apply to personal service corporations and to closely held C corporations. (Closely held corporations may deduct passive losses to the extent of their net active income but not portfolio income.) For S corporations (and partnerships), the passive loss rules apply at the shareholder (partner) level.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

21. Peach Corporation had $210,000 of net active income, $45,000 of portfolio income, and a $230,000 passive loss during the current year. If Peach is a closely held C corporation that is not a PSC, it can deduct $210,000 of the passive loss in the year.

a. True

b. False

ANSWER: True

RATIONALE: If Peach is a closely held corporation that is not a PSC, the passive loss is deductible to the extent of the corporation’s net active income, or $210,000.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

22. On December 16, 2016, the directors of Quail Corporation (an accrual basis, calendar year taxpayer) authorized a cash donation of $5,000 to the American Cancer Society, a qualified charity. The payment, which is made on April 11, 2017, may be claimed as a deduction for tax year 2016.

a. True

b. False

ANSWER: True

RATIONALE: In order to be deductible in the year authorized by the board of directors, a charitable contribution must be paid within 3 1/2 months of the end of the year of authorization (April 15, 2017, in this case) and must involve an accrual basis corporation. Because payment was made on April 11, 2017, the contribution is deductible in 2016.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02

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STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 2 min.

23. In the current year, Oriole Corporation donated a painting worth $30,000 to the Texas Art Museum, a qualified public charity. The museum included the painting in its permanent collection. Oriole Corporation purchased the painting 5 years ago for $10,000. Oriole's charitable contribution deduction is $30,000 (ignoring the taxable income limitation).

a. True
b. False

ANSWER: True
RATIONALE: The painting is capital gain property which the museum puts to a use that is related to its exempt function. Thus, the amount of the deduction is equal to the fair market value of the painting, or $30,000.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 2 min.

24. Crow Corporation, a C corporation, donated scientific property (basis of $30,000, fair market value of $50,000) to State University, a qualified charitable organization, to be used in research. Crow had held the property for four months as inventory. Crow Corporation may deduct $50,000 for the charitable contribution (ignoring the taxable income limitation).

a. True
b. False

ANSWER: False
RATIONALE: The scientific property is ordinary income property but it qualifies for the increased deduction amount available for certain corporate contributions of inventory. As such, the amount of the deduction is equal to the lesser of (1) the sum of the inventory's basis plus 50% of the appreciation on the property [$40,000 = $30,000 + 50%($50,000 – $30,000)] or (2) twice the basis [$60,000 = $30,000 × 2]. In this case, the ceiling does not apply, and the deduction amount is $40,000.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 2 min.

25. For a corporation, the domestic production activities deduction is equal to 9% of the lesser of (1) qualified production activities income or (2) taxable income. However, the deduction cannot exceed 50% of the W-2 wages related to qualified production activities income.

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a. True
b. False

ANSWER: True
RATIONALE: For a corporation, the domestic production activities deduction is equal to 9% of the *lower* of (1) qualified production activities income or (2) taxable income. The deduction cannot exceed 50% of the W-2 wages related to qualified production activities income.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 2 min.

26. Heron Corporation, a calendar year C corporation, had an excess charitable contribution for 2015 of $5,000. In 2016, Heron made a further charitable contribution of $20,000. Heron's 2016 deduction is limited to $15,000 (10% of taxable income). The 2016 contribution must be applied first against the $15,000 limitation.

a. True
b. False

ANSWER: True
RATIONALE: The current year's (2016) contribution must be applied first against the taxable income limitation and the carryover (2015) used last.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Application
OTHER: Time: 2 min.

27. A corporate net operating loss can be carried back 2 years and forward 20 years to offset taxable income for those years.

a. True
b. False

ANSWER: True
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 2 min.

28. Azul Corporation, a calendar year C corporation, received a dividend of $30,000 from Naranja Corporation. Azul owns 25% of the Naranja Corporation stock. Assuming it is not subject to the taxable income limitation, Azul's dividends

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received deduction is $21,000.

a. True

b. False

ANSWER: False

RATIONALE: The deduction percentage for a 25% ownership is 80%. Thus, the dividends received deduction would be $24,000 ($30,000 × 80%).

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-03 - LO: 2-03

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 2 min.

29. Because of the taxable income limitation, no dividends received deduction is allowed if a corporation has an NOL for the current taxable year.

a. True

b. False

ANSWER: False

RATIONALE: The taxable income limitation for the dividends received deduction does not apply if a corporation has an NOL for the current taxable year.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-03 - LO: 2-03

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

30. No dividends received deduction is allowed unless the corporation has held the stock for more than 90 days.

a. True

b. False

ANSWER: False

RATIONALE: The corporation must hold the stock for more than *45 days* in order to qualify for the dividends received deduction.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-03 - LO: 2-03

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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KEYWORDS: Bloom's: Comprehension

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31. Hornbill Corporation, a cash basis and calendar year C corporation, was formed and began operations on May 1, 2016. Hornbill incurred the following expenses during its first year of operations (May 1 – December 31, 2016): temporary

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directors meeting expenses of $10,500, state of incorporation fee of $5,000, stock certificate printing expenses of $1,200, and legal fees for drafting corporate charter and bylaws of $7,500. Hornbill Corporation's current year deduction for organizational expenditures is $5,800.

a. True

b. False

ANSWER:	True
RATIONALE:	All of the expenses qualify as organizational expenditures except for the stock certificate printing costs ($1,200). Thus, organizational expenditures total $23,000 ($10,500 + $5,000 + $7,500). The current year deduction for organizational expenditures is $5,800 {$5,000 immediate expensing + $800 amortization [($23,000 – $5,000) ÷ 180 × 8 months]}.
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Application
OTHER:	Time: 2 min.

32. Lilac Corporation incurred $4,700 of legal and accounting fees associated with its incorporation. The $4,700 is deductible as startup expenditures on Lilac's tax return for the year in which it begins business.

a. True

b. False

ANSWER:	False
RATIONALE:	The $4,700 is deductible as *organizational* expenditures on Lilac's tax return for the year in which it begins business.
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Comprehension
OTHER:	Time: 2 min.

33. A personal service corporation with taxable income of $100,000 will have a tax liability of $22,250.

a. True

b. False

ANSWER:	False
RATIONALE:	A personal service corporation is subject to the 35% rate on all taxable income; thus, the tax liability is $35,000 ($100,000 × 35%).
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS:	Bloom's: Application

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OTHER: Time: 2 min.

34. Ed, an individual, incorporates two separate businesses that he owns by establishing two new C corporations. Each corporation generates taxable income of $50,000. As a general rule, each corporation will have a tax liability of $11,125.

a. True

b. False

ANSWER: True

RATIONALE: Since the corporations would be members of a controlled group, their taxable income would be combined in applying the corporate income tax rates. The tax on $100,000 would be $22,250, or $11,125 tax for each corporation. If all members of a controlled group consent, an apportionment plan can provide for an unequal allocation of the marginal tax rates.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-05 - LO: 2-05

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 2 min.

35. A calendar year C corporation can receive an automatic 9-month extension to file its corporate return (Form 1120) by timely filing a Form 7004 for the tax year.

a. True

b. False

ANSWER: False

RATIONALE: In general, corporations can receive an automatic extension of *six* months for filing the corporate return by filing Form 7004 by the due date of the return. However, an automatic extension of five months applies for a calendar year C corporation (and seven months for a June 30 year end C corporation).

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

36. A corporation must file a Federal income tax return even if it has no taxable income for the year.

a. True

b. False

ANSWER: True

RATIONALE: A corporation must file a return regardless of whether or not it has taxable income.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Knowledge
OTHER: Time: 2 min.

37. For purposes of the estimated tax payment rules, a “large corporation” is defined as a corporation that had taxable income of $1 million or more in any of the three preceding years.

a. True
b. False

ANSWER: True
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Knowledge
OTHER: Time: 2 min.

38. Schedule M-1 is used to reconcile net income as computed for financial accounting purposes with taxable income reported on the corporation’s income tax return.

a. True
b. False

ANSWER: True
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Knowledge
OTHER: Time: 2 min.

39. An expense that is deducted in computing net income per books but not deductible in computing taxable income is a subtraction item on Schedule M-1.

a. True
b. False

ANSWER: False
RATIONALE: An expense that is deducted in computing net income per books but not deductible in computing taxable income is an *addition* item on Schedule M-1.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 2 min.

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40. On December 31, 2016, Flamingo, Inc., a calendar year, accrual method C corporation, accrues a bonus of $50,000 to its president (a cash basis taxpayer), who owns 75% of the corporation's outstanding stock. The $50,000 bonus is paid to the president on February 2, 2017. For Flamingo's 2016 Form 1120, the $50,000 bonus will be a subtraction item on Schedule M-1.

a. True

b. False

ANSWER:	False
RATIONALE:	The bonus is entered as an *addition* item on Schedule M-1. Since Flamingo is accruing an expenditure with respect to a cash basis related party (i.e., more than 50% shareholder), the $50,000 bonus is not deductible until such time it is included in the president's gross income (2017). An item that is an expense in computing net income per books but not deductible in computing taxable income is an *addition* item on Schedule M-1.
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Comprehension
OTHER:	Time: 2 min.

41. Income that is included in net income per books but not included in taxable income is a subtraction item on Schedule M-1.

a. True

b. False

ANSWER:	True
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Comprehension
OTHER:	Time: 2 min.

42. Schedule M-2 is used to reconcile unappropriated retained earnings at the beginning of the year with unappropriated retained earnings at the end of the year.

a. True

b. False

ANSWER:	True
POINTS:	1
DIFFICULTY:	Easy
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Knowledge
OTHER:	Time: 2 min.

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43. A corporation with $5 million or more in assets must file Schedule M-3 (instead of Schedule M-1).

a. True

b. False

ANSWER: False

RATIONALE: A corporation with *$10 million* or more in assets must file Schedule M-3 (instead of Schedule M-1).

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

44. Schedule M-3 is similar to Schedule M-1 in that the form is designed to reconcile net income per books with taxable income. However, an objective of Schedule M-3 is more transparency between financial statements and tax returns than that provided by Schedule M-1.

a. True

b. False

ANSWER: True

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

45. Juanita owns 60% of the stock in a C corporation that had a profit of $200,000 in 2016. Carlos owns a 60% interest in a partnership that had a profit of $200,000 during the year. The corporation distributed $45,000 to Juanita, and the partnership distributed $45,000 to Carlos. Which of the following statements relating to 2016 is *incorrect*?

a. Juanita must report $120,000 of income from the corporation.

b. The corporation must pay corporate tax on $200,000 of income.

c. Carlos must report $120,000 of income from the partnership.

d. The partnership is not subject to a Federal entity-level income tax.

e. None of the above.

ANSWER: a

RATIONALE: Shareholders of C corporations report the dividends received from the corporation during the year. Thus, Juanita must report $45,000 of income from the corporation. The other statements are correct.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

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KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

46. Bjorn owns a 60% interest in an S corporation that earned $150,000 in 2016. He also owns 60% of the stock in a C corporation that earned $150,000 during the year. The S corporation distributed $30,000 to Bjorn and the C corporation paid dividends of $30,000 to Bjorn. How much income must Bjorn report from these businesses?

a. $0 income from the S corporation and $30,000 income from the C corporation.
b. $30,000 income from the S corporation and $30,000 of dividend income from the C corporation.
c. $90,000 income from the S corporation and $0 income from the C corporation.
d. $90,000 income from the S corporation and $30,000 income from the C corporation.
e. None of the above.

ANSWER: d
RATIONALE: Bjorn must report his $90,000 share ($150,000 × 60%) of the S corporation's income on his individual tax return. He will report $30,000 of dividend income from the C corporation.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

47. Rachel is the sole member of an LLC, and Jordan is the sole shareholder of a C corporation. Both businesses were started in the current year, and each business has a long-term capital gain of $10,000 for the year. Neither business made any distributions during the year. With respect to this information, which of the following statements is correct?

a. The C corporation receives a preferential tax rate on the LTCG of $10,000.
b. The LLC must pay corporate tax on taxable income of $10,000.
c. Jordan must report $10,000 of LTCG on his tax return.
d. Rachel must report $10,000 of LTCG on her tax return.
e. None of the above.

ANSWER: d
RATIONALE: Under the default rules of the check-the-box Regulations, a single-member LLC is treated as a proprietorship for Federal tax purposes. As such, Rachel reports the $10,000 LTCG on her tax return (Form 1040). A C corporation does not receive preferential tax rate treatment on LTCG (option a.). The LLC is ignored for Federal income tax purposes and its income, gains, deductions, and losses are reported as a proprietorship, not as a corporation (option b.). A C corporation is a separate taxpaying entity (Form 1120) and income of a C corporation is not taxed to its shareholders until distributed as dividends (option c.).
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

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48. Norma formed Hyacinth Enterprises, a proprietorship, in 2016. In its first year, Hyacinth had operating income of $400,000 and operating expenses of $240,000. In addition, Hyacinth had a long-term capital loss of $10,000. Norma, the proprietor of Hyacinth Enterprises, withdrew $75,000 from Hyacinth during the year. Assuming Norma has no other capital gains or losses , and ignoring any self-employment taxes, how does this information affect her adjusted gross income for 2016?

a. Increases Norma's adjusted gross income by $157,000 ($160,000 ordinary business income – $3,000 long-term capital loss).
b. Increases Norma's adjusted gross income by $150,000 ($160,000 ordinary business income – $10,000 long-term capital loss).
c. Increases Norma's adjusted gross income by $75,000.
d. Increases Norma's adjusted gross income by $160,000.
e. None of the above.

ANSWER: a

RATIONALE: A proprietorship is not a separate taxable entity. As a proprietor, Norma reports profit or loss from Hyacinth on her individual return. Norma's adjusted gross income for 2016 will be increased by $157,000 ($400,000 – $240,000 = $160,000 net ordinary business income – $3,000 capital loss deduction). The $75,000 she withdrew from Hyacinth has no effect on her adjusted gross income.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-02 - LO: 2-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

49. Pablo, a sole proprietor, sold stock held as an investment for a $40,000 long-term capital gain. Pablo's marginal tax rate is 33%. Loon Corporation, a C corporation, sold stock held as an investment for a $40,000 long-term capital gain. Loon's marginal tax rate is 35%. What tax rates are applicable to these capital gains?

a. 15% rate applies to Pablo and 35% rate applies to Loon.
b. 15% rate applies to Loon and 33% rate applies to Pablo.
c. 35% rate applies to Loon and 33% rate applies to Pablo.
d. 15% rate applies to both Pablo and Loon.
e. None of the above.

ANSWER: a

RATIONALE: Pablo reports the LTCG on his individual tax return (Form 1040, Schedule D), and it is subject to a maximum tax rate of 15%. Loon reports the LTCG on its corporate return (Form 1120) but the gain does not receive preferential tax rate treatment. Therefore, the LTCG will be taxed at 35%.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-02 - LO: 2-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

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KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

50. Lucinda is a 60% shareholder in Rhea Corporation, a calendar year S corporation. During the year, Rhea Corporation had gross income of $550,000 and operating expenses of $380,000. In addition, the corporation sold land that had been held for investment purposes for a short-term capital gain of $30,000. During the year, Rhea Corporation distributed $50,000 to Lucinda. With respect to this information, which of the following statements is correct?

a. Rhea Corporation will pay tax on taxable income of $200,000.
b. Lucinda reports ordinary income of $50,000.
c. Lucinda reports ordinary income of $120,000.
d. Lucinda reports ordinary income of $102,000 and a short-term capital gain of $18,000.
e. None of the above.

ANSWER: d
RATIONALE: Rhea Corporation, an S corporation, is not a taxpaying entity (option a.). Its profit (loss) and separate items flow through to the shareholders. The corporation's Form 1120S reports ordinary business income of $170,000 ($550,000 income – $380,000 expenses). The corporation also reports the $30,000 short-term capital gain as a separately stated item. Lucinda receives a Schedule K-1 reporting ordinary business income of $102,000 (60% × $170,000) and separately stated short-term capital gain of $18,000 (60% × $30,000), and she will report such income on her own return. The distributions are not taxable for Lucinda but decrease the basis in her Rhea Corporation stock.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

51. Elk, a C corporation, has $370,000 operating income and $290,000 operating expenses during the year. In addition, Elk has a $10,000 long-term capital gain and a $17,000 short-term capital loss. Elk's taxable income is:

a. $63,000.
b. $73,000.
c. $80,000.
d. $90,000.
e. None of the above.

ANSWER: c
RATIONALE: $370,000 (operating income) – $290,000 (operating expenses) + $10,000 (LTCG) – $10,000 (STCL) = $80,000 taxable income. A corporation cannot deduct a net capital loss in the year incurred. The net capital loss ($7,000) can be carried back three years and offset against net capital gain in the carryback years. If the capital loss is not used in the carryback, it can be carried forward five years. Capital gains of corporations are included in taxable income and are not subject to the favorable rates applicable to individuals.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic

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STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement

United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

52. Flycatcher Corporation, a C corporation, has two equal individual shareholders, Nancy and Pasqual. In the current year, Flycatcher earned $100,000 net profit and paid a dividend of $10,000 to each shareholder. Regardless of any tax consequences resulting from their interests in Flycatcher, Nancy is in the 33% marginal tax bracket and Pasqual is in the 15% marginal tax bracket. With respect to the current year, which of the following statements is *incorrect*?

a. Flycatcher cannot avoid the corporate tax altogether by distributing all $100,000 of net profit as dividends to the shareholders.
b. Nancy incurs income tax of $1,500 on her dividend income.
c. Pasqual incurs income tax of $1,500 on his dividend income.
d. Flycatcher pays corporate tax of $22,250.
e. None of the above.

ANSWER: c

RATIONALE: A preferential tax rate of 0% applies to dividend income of individual taxpayers in the lowest two marginal tax brackets (10% or 15%); thus, Pasqual pays income tax of $0 on his dividend income. A preferential tax rate of 15% applies to dividend income of individual taxpayers in the 33% tax rate brackets; thus, Nancy pays income tax of $1,500 on her dividend income (option b.). Dividend distributions are not deductible by a corporation, and Flycatcher still incurs corporate tax on $100,000 even if all profits were distributed to shareholders (option a.). Corporate tax on $100,000 of taxable income is $22,250 (option d.).

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

53. Which of the following statements is *incorrect* about LLCs and the check-the-box Regulations?

a. If a limited liability company with more than one owner does not make an election, the entity is taxed as a corporation.
b. All 50 states have passed laws that allow LLCs.
c. An entity with more than one owner and formed as a corporation cannot elect to be taxed as a partnership.
d. If a limited liability company with one owner does not make an election, the entity is taxed as a sole proprietorship.
e. A limited liability company with one owner can elect to be taxed as a corporation.

ANSWER: a

RATIONALE: If a limited liability company with more than one owner does not make an election, the entity is taxed as a partnership. The other statements are correct.

POINTS: 1

DIFFICULTY: Easy

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LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 5 min.

54. Patrick, an attorney, is the sole shareholder of Gander Corporation, a C corporation. Gander is a personal service corporation with a fiscal year ending November 30 (pursuant to a § 444 election). The corporation paid Patrick a salary of $180,000 during its fiscal year ending November 30, 2016. How much salary must Gander pay Patrick during the period December 1 through December 31, 2016, to permit the corporation to continue to use its fiscal year without negative tax effects?

a. $0
b. $30,000
c. $165,000
d. $180,000
e. None of the above

ANSWER: e
RATIONALE: The salary for the deferral period (December 1 through December 31) must be at least proportionate to the employee's salary received for the fiscal year. The amount that Gander Corporation must pay Patrick during the period December 1 through December 31, 2016, to permit the continued use of its fiscal year without negative tax effects, is $15,000 ($180,000 × 1/12).
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

55. Saleh, an accountant, is the sole shareholder of Turquoise Corporation, a C corporation. Turquoise is a personal service corporation with a fiscal year ending September 30 (pursuant to a § 444 election). The corporation paid Saleh a salary of $330,000 during its fiscal year ending September 30, 2016. How much salary must Turquoise pay Saleh during the period October 1 through December 31, 2016, if the corporation is to continue to use its fiscal year without negative tax effects?

a. $0
b. $27,500
c. $82,500
d. $247,500
e. None of the above

ANSWER: c
RATIONALE: The salary for the deferral period (October through December) must be at least proportionate to the employee's salary received for the fiscal year. The amount that Turquoise Corporation must pay Saleh during the period October 1 through December 31, 2016, to permit Turquoise to continue to use its fiscal year without negative tax effects is $82,500 ($330,000 × 3/12).
POINTS: 1

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DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

56. Copper Corporation, a C corporation, had gross receipts of $5 million in 2013, $6 million in 2014, and $3 million in 2015. Gold Corporation, a personal service corporation (PSC), had gross receipts of $4 million in 2013, $7 million in 2014, and $5 million in 2015. Which of the corporations will be allowed to use the cash method of accounting in 2016?

a. Copper Corporation only.
b. Gold Corporation only.
c. Both Copper Corporation and Gold Corporation.
d. Neither Copper Corporation nor Gold Corporation.
e. None of the above.

ANSWER: c
RATIONALE: Copper Corporation can use the cash receipts method because it had average annual gross receipts of $5 million or less ($14 million ÷ 3 = $4.67 million) during the three preceding years. Gold Corporation, a PSC, may use the cash method without regard to its gross receipts.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

57. On December 31, 2016, Peregrine Corporation, an accrual method, calendar year taxpayer, accrued a performance bonus of $100,000 to Charles, a cash basis, calendar year taxpayer. Charles is president and sole shareholder of the corporation. When can Peregrine deduct the bonus?

a. In 2016, if the bonus was authorized by the Board of Directors and payment was made on or before April 15, 2017.
b. In 2017, if payment was made at any time during that year.
c. In 2016, if payment was made on or before April 15, 2017.
d. In 2017, but only if payment was made on or before April 15, 2017.
e. None of the above.

ANSWER: b
RATIONALE: Because Charles is a related party (i.e., more than 50% shareholder). Peregrine's deduction for the bonus must wait until Charles includes the bonus in gross income. Charles, who is a cash basis, calendar year taxpayer, will include the payment in gross income in the year he receives it from Peregrine. Therefore, if Peregrine pays Charles the bonus anytime in 2017, the corporation can deduct the bonus in 2017.
POINTS: 1
DIFFICULTY: Easy

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STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 5 min.

58. Ivory Corporation, a calendar year, accrual method C corporation, has two cash method, calendar year shareholders who are unrelated to each other. Craig owns 35% of the stock, and Oscar owns the remaining 65%. During 2016, Ivory paid a salary of $100,000 to each shareholder. On December 31, 2016, Ivory accrued a bonus of $25,000 to each shareholder. Assuming that the bonuses are paid to the shareholders on February 3, 2017, compute Ivory Corporation's 2016 deduction for the above amounts.

a. $250,000
b. $225,000
c. $200,000
d. $125,000
e. None of above

ANSWER: b
RATIONALE: A corporation that uses the accrual method cannot claim a deduction for an accrual with respect to a related party until the recipient reports that amount as income. Thus, Ivory cannot deduct the $25,000 bonus attributable to Oscar, a related party (i.e., more than 50% shareholder), until 2017. Ivory can deduct in 2016 the salary payments made to each shareholder plus the accrued bonus to Craig, or $225,000 ($100,000 salary + $100,000 salary + $25,000 bonus).
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

59. Carrot Corporation, a C corporation, has a net short-term capital gain of $65,000 and a net long-term capital loss of $250,000 during 2016. Carrot Corporation had taxable income from other sources of $720,000. Prior years' transactions included the following:

2012	Net long-term capital gain	$150,000
2013	Net short-term capital gain	60,000
2014	Net short-term capital gain	45,000
2015	Net long-term capital gain	35,000

Compute the amount of Carrot's capital loss carryover to 2017.

a. $0
b. $32,000
c. $45,000
d. $185,000
e. None of the above

ANSWER: c

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RATIONALE:

Net short-term capital gain for 2016	$ 65,000
Net long-term capital loss for 2016	(250,000)
Net capital loss	($185,000)

The net capital loss of $185,000 is not deductible in 2016, but must be carried back to the three preceding years, applying it to 2013, 2014, and 2015, in that order. The net capital loss is carried back or forward as short-term capital loss.

2016 net capital loss	($185,000)
Offset against	
2013 (net short-term capital gain)	$ 60,000
2014 (net short-term capital gain)	45,000
2015 (net long-term capital gain)	35,000
Total carrybacks	$140,000

Carrot's capital loss carryover is $45,000 ($185,000 – $140,000), which may be carried over to 2017, 2018, 2019, 2020, and 2021, in that order.

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 10 min.

60. In 2016, Bluebird Corporation had net income from operations of $100,000. Further, Bluebird recognized a long-term capital gain of $30,000, and a short-term capital loss of $45,000. Which of the following statements is correct?

a. Bluebird Corporation will have taxable income in 2016 of $100,000 and will have a net capital loss of $15,000 that can be carried back 3 years and forward 5 years.
b. Bluebird Corporation may use the capital loss to offset the capital gain and must carry the net capital loss of $15,000 forward five years as a short-term capital loss.
c. Bluebird Corporation may deduct $33,000 of the capital loss in 2016 and may carry forward the remainder of the capital loss indefinitely to offset capital gains.
d. Bluebird Corporation will have taxable income in 2016 of $85,000.
e. None of the above.

ANSWER: a
RATIONALE: The capital loss will offset the $30,000 capital gain. The $15,000 net capital loss can be carried back to the three preceding years to reduce any capital gains in those years. Any remaining loss not offset against capital gains in the three preceding tax years can be carried forward for five years to offset capital gains in those years. The loss will be treated as short-term capital loss when carried back or forward.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting

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KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

61. In the current year, Sunset Corporation (a C corporation) had operating income of $200,000 and operating expenses of $175,000. In addition, Sunset had a $30,000 long-term capital gain, a $52,000 short-term capital loss, and $5,000 tax-exempt interest income. What is Sunset Corporation's taxable income for the year?

a. $0
b. $3,000
c. $22,000
d. $30,000
e. None of the above

ANSWER: e
RATIONALE: $25,000 ($200,000 operating income – $175,000 operating expenses + $30,000 LTCG – $30,000 STCL). The $22,000 net capital loss is not deductible in the year incurred; rather, the loss is carried back three years and forward five years. The tax-exempt interest income is excluded from gross income.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

62. Beige Corporation, a C corporation, purchases a warehouse on August 1, 2000, for $1 million. Straight-line depreciation is taken in the amount of $411,750 before the property is sold on June 11, 2016, for $1.2 million. What is the amount and character of the gain recognized by Beige on the sale of the realty?

a. Ordinary income of $0 and § 1231 gain of $611,750.
b. Ordinary income of $411,750 and § 1231 gain of $200,000.
c. Ordinary income of $82,350 and § 1231 gain of $529,400.
d. Ordinary income of $117,650 and § 1231 gain of $494,100.
e. None of the above.

ANSWER: c
RATIONALE: First, determine the recognized gain:

Sales price		$1,200,000
Less adjusted basis:		
Cost of property	$1,000,000	
Less cost recovery	(411,750)	(588,250)
Recognized gain		$611,750

Second, determine the § 1245 recapture potential. This is the lesser of $611,750 (recognized gain) or $411,750 (cost recovery claimed).

Third, determine the normal § 1250 recapture amount:

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Cost recovery taken	$411,750
Less straight-line cost recovery	(411,750)
§ 1250 ordinary income	$ —0—

Fourth, because the taxpayer is a corporation, determine the additional § 291 amount:

§ 1245 recapture potential	$411,750
Less § 1250 recapture amount	(–0–)
Excess § 1245 recapture potential	$411,750
Apply § 291 percentage	20%
Additional ordinary income under § 291	$ 82,350

Beige Corporation's recognized gain of $611,750 is accounted for as follows:

Ordinary income under § 1250	$ –0–
Ordinary income under § 291	82,350
§ 1231 gain	529,400
Total recognized gain	$611,750

POINTS: 1
DIFFICULTY: Challenging
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement

United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Application
OTHER: Time: 10 min.

63. During the current year, Woodchuck, Inc., a closely held personal service corporation, has $115,000 of net active income, $40,000 of portfolio income, and $135,000 of passive activity loss. What is Woodchuck's taxable income for the current year?

a. $0
b. $20,000
c. $40,000
d. $155,000
e. None of the above

ANSWER: d
RATIONALE: Personal service corporations cannot offset passive activity losses against either active or portfolio income. Thus, Woodchuck's taxable income is $155,000 ($115,000 net active income + $40,000 portfolio income).
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Application

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OTHER: Time: 5 min.

64. Grackle Corporation, a personal service corporation, had $230,000 of net active income, $40,000 of portfolio income, and a $250,000 passive activity loss during the year. How much is Grackle's taxable income?

a. $20,000
b. $40,000
c. $270,000
d. $520,000
e. None of the above

ANSWER: c
RATIONALE: A personal service corporation may not offset passive activity loss against net active income or portfolio income. Thus, Grackle's taxable income is $270,000 ($230,000 + $40,000).
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

65. Grebe Corporation, a closely held corporation that is not a PSC, had $75,000 of net active income, $60,000 of portfolio income, and a $105,000 passive activity loss during the year. How much of the passive activity loss can Grebe deduct in the current year?

a. $0
b. $60,000
c. $105,000
d. $135,000
e. None of the above

ANSWER: e
RATIONALE: As a closely held corporation that is not a PSC, Grebe may offset $75,000 of the $105,000 passive activity loss against the $75,000 of net active income, but may not offset any of the remaining $30,000 of passive activity loss against portfolio income.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

66. During the current year, Violet, Inc., a closely held corporation (not a PSC), has $55,000 of passive activity loss, $80,000 of net active income, and $20,000 of portfolio income. How much is Violet's taxable income for the current year?

a. $20,000

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b. $45,000
c. $80,000
d. $100,000
e. None of the above

ANSWER: b

RATIONALE: A closely held corporation that is not a PSC can deduct passive activity losses against net active income but not portfolio income. Thus, Violet's taxable income is $45,000 [$80,000 (net active income) + $20,000 (portfolio income) – $55,000 (passive activity loss)].

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

67. During the current year, Owl Corporation (a C corporation), a retailer of children's apparel, made the following donations to qualified charitable organizations.

	Adjusted Basis	Fair Market Value
Children's clothing held as inventory, to Haven for Hope	$10,000	$15,000
Stock in Exxon Corporation acquired two years ago and held as an investment, to City University	5,000	3,000
Land acquired four years ago and held as an investment, to Humane Society	50,000	75,000

How much qualifies for the charitable contribution deduction (ignoring the taxable income limitation)?

a. $63,000
b. $65,000
c. $90,500
d. $92,500
e. None of the above

ANSWER: c

RATIONALE: Since Owl is a corporation and the inventory exception is met, one-half of the appreciation on the clothing may be claimed, or $2,500 [.50($15,000 – $10,000)]. Therefore, $12,500 ($10,000 basis + $2,500 appreciation) is the contribution amount for the inventory. The Exxon stock was loss property (fair market value less than basis); therefore, the contribution amount is the stock's fair market value, or $3,000. The land is capital gain property, an appreciated capital asset held more than one year, and the contribution amount is the land's fair market value, or $75,000. Thus, the total amount of contributions for Owl Corporation is $90,500 ($12,500 + $3,000 + $75,000).

POINTS: 1

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DIFFICULTY: Challenging
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 10 min.

68. In the current year, Plum Corporation, a computer manufacturer, donated 100 laptop computers to a local university (a qualified educational organization). The computers were constructed by Plum earlier this year, and the university will use the computers for research and research training. Plum's basis in the computers is $35,000, and their fair market value is $120,000. What is Plum's deduction for the contribution of the computers (ignoring the taxable income limitation)?

a. $35,000
b. $70,000
c. $77,500
d. $85,000
e. $120,000

ANSWER: b
RATIONALE: The contribution of computers qualifies for the increased contribution amount available with respect to certain inventory. The contribution amount is equal to the lesser of (1) the sum of the property's basis plus 50% of the appreciation on the property [$77,500 = $35,000 basis + .5($120,000 fair market value – $35,000 basis)] or (2) twice the property's basis ($70,000 = 2 × $35,000 basis). Thus, Plum's deduction for the charitable contribution of the inventory is $70,000.
POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

69. During the current year, Kingbird Corporation (a calendar year C corporation) had the following income and expenses:

Income from operations	$200,000
Expenses from operations	140,000
Dividends received (15% ownership)	15,000
Domestic production activities deduction	2,000

On October 1, Kingbird Corporation made a contribution to a qualified charitable organization of $9,000 in cash (not included in any of the above items). Determine Kingbird's charitable contribution deduction for the current year.

a. $9,000
b. $7,500
c. $6,650
d. $6,450
e. None of the above

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ANSWER: b

RATIONALE:

Income from operations	$200,000
Dividends received	15,000
Subtotal	$215,000
Less: Expenses from operations	(140,000)
Limitation base for contributions	$ 75,000
Allowable contribution percentage	× 10%
Charitable contribution allowed	$ 7,500

The charitable contribution deduction is based on taxable income determined without regard to the charitable contribution deduction, any net operating loss carryback or capital loss carryback, dividends received deduction, and domestic production activities deduction.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

70. Pink, Inc., a calendar year C corporation, manufactures golf gloves. For the current year, Pink had taxable income (before DPAD) of $900,000, qualified domestic production activities income of $750,000, and W-2 wages related to qualified production activities income of $140,000. Pink's domestic production activities deduction for the current year is:

a. $0.
b. $12,600.
c. $67,500.
d. $70,000.
e. None of the above.

ANSWER: c

RATIONALE: Pink's tentative domestic production activities deduction is 9% of the lesser of:

- Taxable income (before DPAD) $900,000
- Qualified production activities income $750,000

The tentative deduction is $67,500 ($750,000 × 9%), and the wage limitation does not apply ($140,000 × 50% = $70,000). Therefore, Pink's domestic production activities deduction is $67,500.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

71. In the current year, Crimson, Inc., a calendar C corporation, has income from operations of $180,000 and operating

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deductions of $225,000. Crimson also had $30,000 of dividends from a 15% stock ownership in a domestic corporation. Which of the following statements is correct with respect to Crimson for the current year?

a. Crimson's NOL is $15,000.
b. A dividends received deduction is not allowed in computing Crimson's NOL.
c. The NOL is carried back 3 years and forward 10 years by Crimson.
d. Crimson's dividends received deduction is $21,000.
e. None of the above.

ANSWER: d
RATIONALE: A 70% dividends received deduction is allowed for a 15% stock ownership, resulting in a deduction of $21,000 (70% × $30,000 dividends). The taxable income limitation does not apply as Crimson has an NOL with the normal dividends received deduction of $21,000. Crimson's NOL is $36,000 ($180,000 operating income + $30,000 dividends – $225,000 operating deductions – $21,000 DRD) (choice a.). Generally, an NOL is carried back 2 years and forward 20 years, but a corporation can elect to forgo the carryback period and just carry the NOL forward (choice c.).
POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

72. Which of the following statements is *incorrect* with respect to the treatment of net operating losses by corporations?

a. A corporation may elect to forgo the carryback period and just carryforward an NOL.
b. A corporation may claim a dividends received deduction in computing an NOL.
c. An NOL is generally carried back 2 years and forward 20 years.
d. Unlike individuals, corporations do not adjust their NOLs for net capital losses or nonbusiness deductions.
e. None of the above.

ANSWER: e
RATIONALE: All of the statements are correct with respect to a corporate NOL.
POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
CPET.SWFT.LO: 2-07 - LO: 2-07
NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Knowledge
OTHER: Time: 5 min.

73. Red Corporation, which owns stock in Blue Corporation, had net operating income of $200,000 for the year. Blue pays Red a dividend of $40,000. Red takes a dividends received deduction of $28,000. Which of the following statements is correct?

a. Red owns 80% of Blue Corporation.
b. Red owns 20% or more, but less than 80% of Blue Corporation.

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c. Red owns 80% or more of Blue Corporation.
d. Red owns less than 20% of Blue Corporation.
e. None of the above.

ANSWER: d
RATIONALE: Red's dividends received deduction is 70% of the dividend received ($28,000 ÷ $40,000). The 70% dividends received deduction applies if ownership is less than 20%.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 5 min.

74. Eagle Corporation owns stock in Hawk Corporation and has taxable income of $100,000 for the year before considering the dividends received deduction. Hawk Corporation pays Eagle a dividend of $130,000, which was considered in calculating the $100,000. What amount of dividends received deduction may Eagle claim if it owns 15% of Hawk's stock?

a. $0
b. $70,000
c. $91,000
d. $104,000
e. None of the above

ANSWER: b
RATIONALE: The dividends received deduction depends upon the percentage of ownership by the corporate shareholder. Because Eagle Corporation owns 15% of Hawk Corporation, Eagle would qualify for a 70% deduction, calculated as shown below.

1. Multiply the dividends received by the deduction percentage ($130,000 × 70% = $91,000).
2. Multiply the taxable income before the dividends received deduction by the deduction percentage ($100,000 × 70% = $70,000).
3. Limit the deduction to the lesser of step 1 or step 2, unless subtracting the amount derived in step 1 ($91,000) from taxable income before the dividends received deduction ($100,000) generates an NOL ($100,000 – $91,000 = $9,000 taxable income). If so, use the amount derived in step 1 ($91,000). In this case, the NOL exception to the taxable income limitation does not apply, and the deduction equals $70,000.

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application

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OTHER: Time: 5 min.

75. Copper Corporation owns stock in Bronze Corporation and has net operating income of $900,000 for the year. Bronze Corporation pays Copper a dividend of $150,000. What amount of dividends received deduction may Copper claim if it owns 85% of Bronze stock (assuming Copper's dividends received deduction is not limited by its taxable income)?

a. $97,500
b. $105,000
c. $120,000
d. $150,000
e. None of the above

ANSWER: d
RATIONALE: The dividends received deduction depends upon the percentage of ownership by the corporate shareholder. If Copper Corporation owns 85% of Bronze Corporation, Copper would qualify for a 100% deduction, or $150,000 in this case.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

76. Orange Corporation owns stock in White Corporation and has net operating income of $400,000 for the year. White Corporation pays Orange a dividend of $60,000. What amount of dividends received deduction may Orange claim if it owns 45% of White stock (assuming Orange's dividends received deduction is not limited by its taxable income)?

a. $27,000
b. $42,000
c. $48,000
d. $60,000
e. None of the above

ANSWER: c
RATIONALE: The dividends received deduction depends upon the percentage of ownership by the corporate shareholder. If Orange Corporation owns 45% of White Corporation, Orange would qualify for an 80% deduction, or $48,000 in this case.
POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

77. Which of the following statements is *incorrect* regarding the dividends received deduction?

a. A corporation must hold stock for more than 90 days in order to qualify for a deduction with respect to

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dividends on such stock.

b. The taxable income limitation does not apply with respect to the 100% deduction available to members of an affiliated group.

c. If a stock purchase is financed 75% by debt, the deduction for dividends on such stock is reduced by 75%.

d. The taxable income limitation does not apply if the normal deduction (i.e., 70% or 80% of dividends) results in a net operating loss for the corporation.

e. None of the above.

ANSWER: a

RATIONALE: A corporation must hold stock for more than *45 days* in order to qualify for a deduction with respect to dividends on such stock. All of the other statements are correct.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-03 - LO: 2-03

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 5 min.

78. Emerald Corporation, a calendar year C corporation, was formed and began operations on April 1, 2016. The following expenses were incurred during the first tax year (April 1 through December 31, 2016) of operations.

Expenses of temporary directors and of organizational meetings	$27,000
Fee paid to the state of incorporation	1,000
Accounting services incident to organization	15,500
Legal services for drafting the corporate charter and bylaws	9,500
Expenses incident to the printing and sale of stock certificates	6,000

Assuming a § 248 election, what is the Emerald's deduction for organizational expenditures for 2016?

a. $0

b. $4,550

c. $5,000

d. $7,400

e. None of the above

ANSWER: b

RATIONALE: Qualifying organizational expenditures include these items:

Expenses of temporary directors and of organizational meetings	$27,000
Fee paid to the state of incorporation	1,000
Accounting services incident to organization	15,500
Legal services for drafting the corporate charter and bylaws	9,500
Total	$53,000

Emerald Corporation's deduction under § 248 for 2016 is determined as follows:

Immediate expensing [$5,000 – ($53,000 – $50,000)]	$2,000
Amortization [($53,000 – $2,000) ÷ 180] × 9 (months in tax year)	2,550

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	Total	$4,550

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

79. During the current year, Sparrow Corporation, a calendar year C corporation, had operating income of $425,000, operating expenses of $280,000, a short-term capital loss of $10,000, and a long-term capital gain of $25,000. How much is Sparrow's tax liability for the year?

a. $42,650
b. $42,800
c. $45,650
d. $62,400
e. None of the above

ANSWER: c
RATIONALE: Sparrow's taxable income is $160,000 [$425,000 operating income – $280,000 operating expenses + $15,000 net capital gain ($25,000 long-term capital gain – $10,000 short-term capital loss)]. Corporate income tax on taxable income of $160,000 is $45,650:

Tax on $100,000	$22,250
Tax on $60,000 × 39%	23,400
Total tax liability	$45,650

Corporations do not receive a preferential tax rate on long-term capital gains.
POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
CPET.SWFT.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

80. Nancy Smith is the sole shareholder and employee of White Corporation, a C corporation that is engaged exclusively in accounting services. During the current year, White has operating income of $320,000 and operating expenses (excluding salary) of $150,000. Further, White Corporation pays Nancy a salary of $100,000. The salary is reasonable in amount and Nancy is in the 33% marginal tax bracket irrespective of any income from White. Assuming that White Corporation distributes all after-tax income as dividends, how much total combined income tax do White and Nancy pay in the current year? (Ignore any employment tax considerations.)

a. $56,125
b. $64,325
c. $67,625

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d. $84,000

e. None of the above

ANSWER: b

RATIONALE: White Corporation is a personal service corporation; thus, a 35% flat tax rate applies to its taxable income of $70,000 [$320,000 (operating income) – $100,000 (salary expense) – $150,000 (other operating expenses)]; thus, corporate income tax is $24,500. White's after-tax income distributed to Nancy therefore equals $45,500 ($70,000 – $24,500). Nancy incurs income tax of $33,000 ($100,000 × 33%) on the salary income and $6,825 ($45,500 ×15%) on the dividend income, for a total tax of $39,825. Thus, the total combined income tax is $64,325 ($24,500 tax to White Corporation + $39,825 tax to Nancy).

POINTS: 1

DIFFICULTY: Challenging

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-04 - LO: 2-04

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 10 min.

81. Which of the following statements is *incorrect* regarding the taxation of C corporations?

a. Similar to those applicable to individuals, the marginal tax rate brackets for corporations are adjusted for inflation.

b. Taxable income of a personal service corporation is taxed at a flat rate of 35%.

c. A tax return must be filed whether or not the corporation has taxable income.

d. The highest corporate marginal tax rate is 39%.

e. None of the above.

ANSWER: a

RATIONALE: The marginal tax rate brackets for corporations are *not* adjusted for inflation.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-04 - LO: 2-04
CPET.SWFT.LO: 2-06 - LO: 2-06

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 5 min.

82. Which of the following statements is correct regarding the taxation of C corporations?

a. Schedule M-2 is used to reconcile net income computed for financial accounting purposes with taxable income reported on the corporation's tax return.

b. The corporate return is filed on Form 1120S.

c. Corporations can receive an automatic extension of nine months for filing the corporate return by filing Form 7004 by the due date for the return.

d. A corporation with total assets of $7.5 million or more is required to file Schedule M-3.

e. None of the above.

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ANSWER: e

RATIONALE: *Schedule M-1* is used to reconcile net income computed for financial accounting purposes with taxable income reported on the corporation's tax return. Schedule M-2 is used to reconcile beginning unappropriated retained earnings with ending unappropriated retained earnings (option a.). *Form 1120* is the tax return for a C corporation. Form 1120S is the tax return for an S corporation (option b.). An automatic extension of *six months* (five months in the case of a calendar year corporation and seven months in the case of a June 30 year end corporation) is available by filing a timely Form 7004 (option c.). Corporations with total assets of *$10 million* or more are required to file Schedule M-3 (option d.).

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 5 min.

83. Robin Corporation, a calendar year C corporation, had taxable income of $1.9 million, $1.2 million, and $900,000 for 2013, 2014, and 2015, respectively. Robin has taxable income of $1.5 million for 2016. The minimum 2016 estimated tax installment payments for Robin are:

a. April 15, 2016, $76,500; June 15, 2016, $76,500; September 15, 2016, $76,500; December 15, 2016, $76,500.
b. April 15, 2016, $110,500; June 15, 2016, $127,500; September 15, 2016, $127,500; December 15, 2016, $127,500.
c. April 15, 2016, $127,500; June 15, 2016, $127,500; September 15, 2016, $127,500; December 15, 2016, $127,500.
d. April 15, 2016, $76,500; June 15, 2016, $178,500; September 15, 2016, $127,500; December 15, 2016, $127,500.
e. None of the above.

ANSWER: d

RATIONALE: A corporation that had taxable income of $1 million or more in any of the three preceding years is a "large corporation" for purposes of utilizing the prior year's tax exception for estimated tax payments. As such, Robin Corporation can use the prior year's tax exception for computing its first 2016 estimated tax payment only, and any shortfall as a result of such use must be paid with the second installment.

Payment	Amount
April 15, 2016	$ 76,500 *
June 15, 2016	178,500 **
September 15, 2016	127,500
December 15, 2016	127,500
Total	$510,000

*Based on preceding year's tax, for first installment only: [$900,000 taxable income × 34% (see Exhibit 2.1)] = $306,000 ÷ 4 = $76,500.
**Based on current year's tax, for remaining installments: [$1.5 million taxable income × 34% (see Exhibit 2.1)] = $510,000 ÷ 4 = $127,500. Second installment must include shortfall from first installment: [$127,500 + ($127,500 – $76,500)] = $178,500.

POINTS: 1

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DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 10 min.

84. Schedule M-1 of Form 1120 is used to reconcile financial net income with taxable income reported on the corporation's income tax return as follows: net income per books + additions – subtractions = taxable income. Which of the following items is an *addition* on Schedule M-1?

a. Domestic production activities deduction.
b. Proceeds of life insurance paid on death of key employee.
c. Excess of capital losses over capital gains.
d. Tax-exempt interest.
e. None of the above.

ANSWER: c
RATIONALE: The other items are *subtractions* on Schedule M-1.
POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 5 min.

85. Schedule M-1 of Form 1120 is used to reconcile financial net income with taxable income reported on the corporation's income tax return as follows: net income per books + additions – subtractions = taxable income. Which of the following items is a *subtraction* on Schedule M-1?

a. Book depreciation in excess of tax depreciation.
b. Excess of capital losses over capital gains.
c. Proceeds on key employee life insurance.
d. Income subject to tax but not recorded on the books.
e. None of the above.

ANSWER: c
RATIONALE: The life insurance proceeds would be included in book income but not in taxable income. Therefore, a subtraction is required to reconcile book income to taxable income. The other items are *additions* on Schedule M-1.
POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 5 min.

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86. During the current year, Skylark Company had operating income of $420,000 and operating expenses of $250,000. In addition, Skylark had a long-term capital loss of $20,000, and a charitable contribution of $5,000. How does Toby, the sole owner of Skylark Company, report this information on his individual income tax return under following assumptions?

a. Skylark is an LLC, and Toby does not withdraw any funds from the company during the year.

b. Skylark is an S corporation, and Toby does not withdraw any funds from the company during the year.

c. Skylark is a regular (C) corporation, and Toby does not withdraw any funds from the company during the year.

ANSWER:

a. A single-member LLC is taxed as a proprietorship. Consequently, Toby reports the $170,000 operating profit, $20,000 long-term capital loss, and $5,000 charitable contribution on his individual return (Form 1040). The capital loss limitation may apply to the LTCL depending on Toby's other capital gains and losses, if any.

b. Income, deductions, gains, and losses of an S corporation flow through to the shareholders. Separately stated items (e.g., LTCL and charitable contribution) retain their character at the shareholder level. Consequently, Toby reports the $170,000 operating profit, $20,000 long-term capital loss, and $5,000 charitable contribution on his individual return (Form 1040). The capital loss limitation may apply to the LTCL.

c. Shareholders of a regular (C) corporation report income from the corporation to the extent of dividends received. Therefore, Toby does not report any of Skylark's operating profit, long-term capital loss, or charitable contribution on his individual return. [Skylark Company would report taxable income of $165,000 ($170,000 operating profit – $5,000 charitable contribution) on its corporate return (Form 1120). The net capital loss of $20,000 is not deductible in the current year; rather, the loss is carried back three years and forward five years (as STCL).]

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Application
OTHER: Time: 10 min.

87. Amber Company has $100,000 in net income in the current year before deducting any compensation or other payment to its sole owner, Alfredo. Assume that Alfredo is in the 33% marginal tax bracket. Discuss the tax aspects of each of the following independent situations. (Assume that any salaries are reasonable in amount and ignore any employment tax considerations.)

a. Alfredo operates Amber Company as a proprietorship.

b. Alfredo incorporates Amber Company and pays himself no salary and no dividend.

c. Alfredo incorporates Amber Company and pays himself a $50,000 salary and a dividend of $42,500 ($50,000 – $7,500 corporate income tax).

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ANSWER:

a. Alfredo's tax on $100,000 at 33% $33,000

b. Amber's tax on $100,000 at corporate rates $22,250

c.

Amber's tax on $50,000 at corporate rates	$ 7,500
Alfredo's tax on $42,500 dividend distributed at 15%	6,375
Alfredo's tax on $50,000 salary at 33%	16,500
Total tax	$30,375

POINTS: 1
DIFFICULTY: Challenging
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 10 min.

88. During the current year, Maroon Company had $125,000 net income from operations. Belinda, the sole owner of Maroon, is in the 33% marginal tax bracket. Determine the combined tax burden for Maroon and Belinda under the following independent situations. (Ignore any employment taxes.)

a. Maroon Company is a C corporation and all of its after-tax income is distributed to Belinda.

b. Maroon Company is a proprietorship and all of its after-tax income is withdrawn by Belinda.

c. Maroon Company is an S corporation and all of its after-tax income is distributed to Belinda.

ANSWER:

a. If Maroon Company is a C corporation, the $125,000 is taxable at the corporate level (Form 1120), resulting in corporate tax of $32,000 [($50,000 × 15%) + ($25,000 × 25%) + ($25,000 × 34%) + ($25,000 × 39%)] . The after-tax dividend distribution of $93,000 ($125,000 – $32,000) to Belinda results in tax of $13,950 ($93,000 ×15%). Total taxes amount to $45,950 ($32,000 + $13,950).

b. If Maroon Company is a proprietorship, there is no entity level Federal income tax. Instead, the income of the proprietorship is reported on Belinda's tax return (Form 1040), resulting in tax of $41,250 ($125,000 × 33%). Belinda's withdrawal of the after-tax income has no income tax consequences.

c. Income, deductions, gains, and losses of an S corporation flow through to the shareholders. Consequently, Belinda reports the $125,000 net profit on her individual return (Form 1040), resulting in tax of $41,250 ($125,000 × 33%). Distributions from S corporations are nontaxable to the shareholder (to the extent of stock basis).

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

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	AICPA: FN-Measurement
KEYWORDS:	Bloom's: Application
OTHER:	Time: 10 min.

89. Canary Corporation, an accrual method C corporation, uses the calendar year for tax purposes. Leticia, a cash method taxpayer, is both a shareholder of Canary and the corporation's CFO. On December 31, 2016, Canary has accrued a $75,000 bonus to Leticia. Describe the tax consequences of the bonus to Canary and to Leticia under the following independent situations.

a. Leticia owns 35% of Canary Corporation's stock and the corporation pays the bonus to Leticia on February 3, 2017.

b. Leticia owns 75% of Canary Corporation's stock and the corporation pays the bonus to Leticia on May 4, 2017.

c. Leticia owns 75% of Canary Corporation's stock and the corporation pays the bonus to Leticia on February 3, 2017.

ANSWER: Under § 267(a)(2), an accrual method taxpayer must defer a deduction for an expenditure attributable to a cash method related party until such time the related party reports the amount as income. For purposes of this limitation, a more-than-50% shareholder of the corporation is a related party.

a. Leticia is not a related party for purposes of the § 267(a)(2) limitation; thus, Canary deducts the bonus, under the accrual method, in 2016. Since Leticia is on the cash method, she includes the bonus in her income in 2017.

b. Since Leticia, a cash method related party, does not include the bonus in her income until its receipt in 2017, Canary's deduction for the bonus occurs in 2017.

c. Again, Leticia is a cash method related party who does not include the bonus in her income until its receipt in 2017; thus, Canary's deduction for the bonus is deferred until 2017. The fact that the payment to Leticia occurs prior to the filing date for Canary's 2016 tax return is of no consequence.

POINTS:	1
DIFFICULTY:	Moderate
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Reporting
KEYWORDS:	Bloom's: Application
OTHER:	Time: 5 min.

90. Ostrich, a C corporation, has a net short-term capital gain of $20,000 and a net long-term capital loss of $90,000 during 2016. Ostrich also has taxable income from other sources of $1 million. Prior years' transactions included the following:

2012 net short-term capital gains	$20,000
2013 net long-term capital gains	15,000

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2014 net short-term capital gains	25,000
2015 net long-term capital gains	5,000

a. How are the capital gains and losses treated on Ostrich's 2016 tax return?
b. Determine the amount of the 2016 net capital loss that is carried back to each of the previous years.
c. Compute the amount of capital loss carryover, if any, and indicate the years to which the loss may be carried.
d. If Ostrich were a proprietorship, how would Ellen, the owner, report these transactions on her 2016 tax return?

ANSWER:

a.

Net short-term capital gain	$ 20,000
Net long-term capital loss	(90,000)
Net capital loss	($70,000)

The net capital loss of $70,000 is not deductible in 2016 but must be carried back to the three preceding years, applying it to 2013, 2014, and 2015, in that order. Such net capital loss is carried back or forward as a short-term capital loss.

b.

2016 net capital loss	($70,000)
Offset against—	
2013 net long-term capital gains	$15,000
2014 net short-term capital gains	25,000
2015 net long-term capital gains	5,000
Total carrybacks	$45,000

c. $25,000 ($70,000 – $45,000) STCL carryover to 2017, 2018, 2019, 2020, and 2021, in that order.

d. Ellen would net these transactions with all other capital transactions for 2016. Assuming these were her only capital transactions in 2016, she would offset $20,000 of capital losses against the capital gains and deduct an additional $3,000 in capital losses on her return. The remaining $67,000 ($90,000 – $20,000 – $3,000) would be carried forward indefinitely as a LTCL.

POINTS:	1
DIFFICULTY:	Moderate
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS:	Bloom's: Application
OTHER:	Time: 10 min.

91. During the current year, Gray Corporation, a C corporation in the financial services business, made charitable contributions to qualified organizations as follows:

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. Stock (basis of $20,000, fair market value of $45,000) in Drab Corporation, held for six months as an investment, to the Salvation Army. (Salvation Army plans on selling the stock.)

. Painting (basis of $90,000, fair market value of $250,000), held for four years as an investment, to the Museum of Fine Arts. (The Museum plans on including the painting in its collection.)

Gray Corporation's taxable income (before any charitable contribution deduction) is $1.8 million.

a. What is the total amount of Gray's charitable contributions for the year?

b. What is the amount of Gray's charitable contribution deduction in the current year, and what happens to any excess charitable contribution, if any?

ANSWER:

a. Gray's total amount of charitable contributions is $270,000 [$20,000 (stock) + $250,000 (painting)], computed as follows:

Stock: this is ordinary income property, as a sale of the stock would *not* result in a long-term capital gain or a § 1231 gain for Gray (i.e., STCG). Thus, the amount of the contribution is the stock's basis, or $20,000.

Painting: this is capital gain property, as a sale of the painting would result in a long-term capital gain for Gray. The painting is tangible personal property and its use is related to the charitable organization's exempt function. Thus, the amount of the contribution is the painting's fair market value, or $250,000.

b. Gray's current year charitable deduction is limited to $180,000 [10% × $1.8 million (taxable income before charitable deduction)], and the excess charitable contribution of $90,000 ($270,000 – $180,000) is carried forward to the five succeeding tax years.

POINTS:	1
DIFFICULTY:	Challenging
LEARNING OBJECTIVES:	CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS:	United States - BUSPORG: Analytic
STATE STANDARDS:	United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS:	Bloom's: Application
OTHER:	Time: 10 min.

92. On December 28, 2016, the board of directors of Taupe Corporation, a calendar year, accrual method C corporation, authorized a contribution of land to a qualified charitable organization. The land (basis of $75,000, fair market value of $125,000) was acquired five years ago and held as an investment. For purposes of the taxable income limitation applicable to charitable deductions, Taupe has taxable income of $800,000 and $950,000 for 2016 and 2017, respectively. Describe the tax consequences to Taupe Corporation under the following independent situations.

a. The donation is made on February 16, 2017.

b. The donation is made on May 11, 2017.

ANSWER: In general, charitable contributions are deductible in the year made. However, in the case of an accrual method corporation, a deduction can be claimed in the current year for a charitable contribution made in the subsequent year if (1) the contribution is approved by the board of

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directors of the corporation in the current year, and (2) the contribution is made on or before the fifteenth day of the fourth month of the subsequent year. The land is capital gain property; thus, the amount of the charitable contribution is the land's fair market value of $125,000.

a. The requirements for an accrual of the charitable deduction are satisfied; thus, the $125,000 contribution is deductible by Taupe in 2016, subject to the taxable income limitation. For 2016, the taxable income limitation for charitable deductions is $80,000 (10% × $800,000). The excess contribution amount of $45,000 carries forward to 2017 (five-year carryover limit).

b. The requirements for an accrual of the charitable deduction are not satisfied; thus, the $125,000 contribution is deductible by Taupe in 2017 (the year the contribution is made), subject to the taxable income limitation. For 2017, the taxable income limitation for charitable deductions is $95,000 (10% × $950,000). The excess contribution amount of $30,000 carries forward to 2018 (five-year carryover limit).

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 10 min.

93. During the current year, Quartz Corporation (a calendar year C corporation) has the following transactions:

Income from operations	$350,000
Expenses from operations	370,000
Dividends received from ABC Corporation	50,000

Quartz owns 25% of ABC Corporation's stock. How much is Quartz Corporation's taxable income (loss) for the year?

ANSWER: Quartz has an NOL, computed as shown below:

Gross income:		
From operations	$350,000	
Dividends	50,000	$400,000
Less:		
Expenses from operations	$370,000	
Dividends received deduction ($50,000 × 80%)	40,000	(410,000)
Net operating loss		($ 10,000)

The dividends received deduction is not limited to the taxable income limitation because it creates a net operating loss.

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic

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STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

94. Warbler Corporation, an accrual method regular corporation, was formed and began operations on March 1, 2016. The following expenses were incurred during its first year of operations (March 1 - December 31, 2016):

Expenses of temporary directors and organizational meetings	$25,000
Incorporation fee paid to state	2,000
Expenses incurred in printing and selling stock certificates	10,000
Accounting services incident to organization	12,000

a. Assuming a valid election under § 248 to amortize organizational expenditures, what is the amount of Warbler's deduction for 2016?

b. Same as a., except that Warbler also incurred in 2016 legal fees of $15,000 for the drafting of the corporate charter and bylaws. What is the amount of Warbler's 2016 deduction for organizational expenditures?

ANSWER:

a. Warbler has qualifying organizational expenditures of $39,000 [$25,000 (expenses of temporary directors and organizational meetings) + $2,000 (incorporation fee) + $12,000 (accounting fees)]. Expenses related to the printing or selling of stock or other securities do not qualify as organizational expenditures. Warbler's 2016 deduction for the organizational expenditures is $6,889 {$5,000 + [($39,000 – $5,000)/180 × 10 months]}.

b. Warbler now has qualifying organizational expenditures of $54,000 [$39,000 (as computed in a., above) + $15,000 (legal fees)]. Warbler's 2016 deduction for the organizational expenditures is $3,944 {$1,000 + [($54,000 – $1,000)/180 × 10 months]}. The $5,000 immediate expensing amount is reduced to the extent qualifying organizational expenditures exceed $50,000; thus, only $1,000 of the expenditures are immediately deductible, and the remainder of the expenditures are amortized over 180 months.

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 10 min.

95. During the current year, Coyote Corporation (a calendar year C corporation) has the following transactions:

Income from operations	$260,000
Expenses from operations	285,000
Dividends received from Roadrunner Corporation	115,000

a. Coyote owns 5% of Roadrunner Corporation's stock. How much is Coyote Corporation's taxable income (loss) for the year?

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b. Would your answer change if Coyote owned 25% of Roadrunner Corporation's stock?

ANSWER:

a. The key to this question is the relationship between the dividends received deduction and the NOL deduction. The dividends received deduction is limited to a percentage of taxable income of the corporation (unless taking the full dividends received deduction would cause or increase an NOL). In this case, the dividends received deduction is limited to 70% of taxable income.

Gross income:		
From operations	$260,000	
Dividends	115,000	$375,000
Less: Expenses from operations		(285,000)
Taxable income before the dividends received deduction		$ 90,000
Dividends received deduction (70% × $90,000)		(63,000)
Taxable income		$ 27,000

The dividends received deduction is limited to 70% of taxable income because taking 70% of $115,000 ($80,500) would not create an NOL.

b. If Coyote Corporation owns 25% of Roadrunner Corporation's stock, the percentage for calculating the dividends received deduction is 80%. Under these circumstances, taking the full dividends received deduction would create an NOL.

Gross income:		
From operations	$260,000	
Dividends	115,000	$375,000
Less: Expenses from operations		(285,000)
Taxable income before the dividends received deduction		$ 90,000
Dividends received deduction (80% × $115,000)		(92,000)
Net operating loss		($ 2,000)

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 10 min.

96. In each of the following independent situations, determine the corporation's income tax liability. Assume that all corporations use a calendar year 2016.

	Taxable Income
Violet Corporation	$ 63,000

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Indigo Corporation	180,000
Orange Corporation	510,000
Blue Corporation	11,100,000
Green Corporation (personal service corporation)	225,000

ANSWER:

Violet Corporation:
Tax on $63,000—
$50,000 × 15% $ 7,500
$13,000 × 25% 3,250
Total tax $10,750

Indigo Corporation:
Tax on $180,000—
$100,000 $22,250
$80,000 × 39% 31,200
Total tax $53,450

Orange Corporation:
Tax on $510,000—
$335,000 $113,900
$175,000 × 34% 59,500
Total tax $173,400

Blue Corporation:
Tax on $11,100,000—
$10,000,000 $3,400,000
$1,100,000 × 35% 385,000
Total tax $3,785,000

Green Corporation (personal service corporation):
Tax on $225,000 × 35% $78,750

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 10 min.

97. Tonya, an actuary, is the sole shareholder of Shrike Corporation, a professional corporation. The corporation paid Tonya a salary of $360,000 during its fiscal year ending September 30, 2016.

a. How much salary must Shrike Corporation pay Tonya during the period October 1 through December 31, 2016, to enable the corporation to continue to use its fiscal year without negative tax effects?

b. If Shrike Corporation had taxable income of $75,000 for the year ending September 30, 2016, what is its tax liability?

ANSWER: a. The salary for the deferral period (October 1 through December 31) must be at least

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proportionate to the employee's salary received for the fiscal year. The amount that Shrike Corporation must pay Tonya during the period October 1 through December 31, 2016, to permit the continued use of its fiscal year without negative tax effects, is $90,000 ($360,000 × 3/12).

b. As a PSC is subject to a tax rate of 35%, Shrike's tax is $26,250 ($75,000 × 35%). To illustrate the negative tax impact of classification as a PSC, compare this amount to the $13,750 that a regular (non-PSC) corporation would pay.

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
CPET.SWFT.LO: 2-04 - LO: 2-04
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 5 min.

98. Almond Corporation, a calendar year C corporation, had taxable income of $900,000, $1.1 million, and $1.2 million for 2013, 2014, and 2015, respectively. Almond's taxable income is $2 million for 2016. Compute the minimum estimated tax payments for 2016 for Almond Corporation.

ANSWER: A corporation that had taxable income of $1 million or more in any of the three preceding years is a "large corporation" for purposes of utilizing the prior year's tax exception for estimated tax payments. As such, Almond Corporation can use the prior year's tax exception for computing its first 2016 estimated tax payment only, and any shortfall as a result of such use must be paid with the second installment.

Payment	Amount	
April 15, 2016	$102,000	*
June 15, 2016	238,000	**
September 15, 2016	170,000	
December 15, 2016	170,000	
Total	$680,000	

*Based on preceding year's tax, for first installment only: ($1.2 million taxable income × 34%) = $408,000 ÷ 4 = $102,000.

**Based on current year's tax, for remaining installments: ($2 million taxable income × 34%) = $680,000 ÷ 4 = $170,000. Second installment must include shortfall from first installment: [$170,000 + ($170,000 – $102,000)] = $238,000.

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement
OTHER: Time: 10 min.

99. Heron Corporation, a calendar year, accrual basis taxpayer, provides the following information for this year and asks

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you to prepare Schedule M-1.

Net income per books (after-tax)	$239,700
Taxable income	195,000
Federal income tax liability	59,300
Interest income from tax-exempt bonds	5,000
Interest paid on loan incurred to purchase tax-exempt bonds	2,000
Life insurance proceeds received as a result of death of Heron's president	100,000
Premiums paid on policy on life of Heron's president	4,500
Excess of capital losses over capital gains	2,000
Retained earnings at beginning of year	375,000
Cash dividends paid	90,000
Tax depreciation in excess of book depreciation	7,500

ANSWER: Net income per books is reconciled to taxable income as follows:

Net income per books (after tax)	$239,700
Plus: Items that decreased net income per books but did not affect taxable income	
+ Federal income tax liability	59,300
+ Excess of capital losses over capital gains	2,000
+ Interest paid on loan incurred to purchase tax-exempt bonds	2,000
+ Premiums paid on policy on life of president of the corporation	4,500
Subtotal	$307,500
Minus: Items that increased net income per books but did not affect taxable income	
– Interest income from tax-exempt bonds	(5,000)
– Life insurance proceeds received as a result of the death of the corporate president	(100,000)
– Tax depreciation in excess of book depreciation	(7,500)
Taxable income	$195,000

POINTS: 1
DIFFICULTY: Challenging
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Application
OTHER: Time: 10 min.

100. Compare the basic tax and nontax factors of doing business as a partnership, an S corporation, and a C corporation. Circle the correct answers.

Tax Questions	Column A Partnership	Column B S Corporation	Column C C Corporation
Who pays tax on the entity's income?	Partners Partnership	Shareholders S corporation	Shareholders C Corporation
Are operating losses passed through to	Yes No	Yes No	Yes No

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owners?

Are capital gains (losses) reported on owners' tax returns as such?	Yes No	Yes No	Yes No
Are distributions of profits taxable to owners?	Yes No	Yes No	Yes No

Nontax Factors	**Partnership**	**S Corporation**	**C Corporation**
Is the liability of owners limited?	Yes No	Yes No	Yes No
Is there free transferability of ownership interests?	Yes No	Yes No	Yes No

ANSWER: The correct answers are shaded.

Tax Questions	Column A Partnership	Column B S Corporation	Column C C Corporation
Who pays tax on the entity's income?	Partners Partnership	Shareholders S corporation	Shareholders C Corporation
Are operating losses passed through to owners?	Yes No	Yes No	Yes No
Are capital gains (losses) reported on owners' tax returns as such?	Yes No	Yes No	Yes No
Are distributions of profits taxable to owners?	Yes No	Yes No	Yes No

Nontax Factors	**Partnership**	**S Corporation**	**C Corporation**
Is the liability of owners limited?	Yes No	Yes No	Yes No
Is there free transferability of ownership interests?	Yes No	Yes No	Yes No

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01

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NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 10 min.

101. A taxpayer is considering the formation of a business that would derive some amounts of tax-exempt interest, qualified dividends, and capital gains. Explain how these income categories would be reported and taxed under the various types of entity forms discussed in the chapter. Consider the tax implications both to the entities and to their owners.

ANSWER: For certain business entity forms, the entity is not subject to a Federal income tax. This is the case with the sole proprietorship, partnership, and (generally) S corporation entity forms. The owners of these three entity forms would benefit from any preferential tax treatment associated with tax-exempt income (i.e., exclusion), qualified dividends (i.e., 0%/15%/20% tax rate), and capital gains (i.e., offset against capital losses and, in the case of LTCG, 0%/15%/20% tax rate). For a sole proprietorship, tax-exempt interest, qualified dividends, and capital gains would all retain their character and be reported as such on the proprietor's tax return (Form 1040, Schedule C). In the case of a partnership (including an LLC treated as a partnership) or S corporation, tax-exempt interest, qualified dividends, and capital gains would be separately reported items on the entity return and retain their character when reported (Schedule K-1) and taxed to the partner or shareholder. The partner or shareholder would include the tax-exempt interest, qualified dividends, and capital gains on the partner's or shareholder's tax return.

In the case of a regular (C) corporation, tax-exempt interest, qualified dividends, and capital gains would be reported as such on the corporate tax return (Form 1120). A corporation would exclude tax-exempt interest from gross income and offset capital gains against capital losses, but corporate taxpayers do not receive any preferential tax rate with respect to qualified dividends or LTCG. Further, the tax attributes of income do not pass through the corporation to the shareholders. Instead, corporate distributions to shareholders generally are taxed as dividend income.

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-07 - LO: 2-07
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 5 min.

102. Adrian is the president and sole shareholder of Pigeon Corporation. He also lends money and rents a building to the corporation. Discuss how these business relationships between Adrian and Pigeon Corporation can help avoid double taxation. What limitations are there on the use of such relationships?

ANSWER: As president of Pigeon Corporation, Adrian can have the corporation pay him a salary. As a creditor, he can have the corporation pay him interest on the loans. As a landlord, he can have the corporation pay him rent. All of these expenses can be deducted by the corporation. In order to avoid disallowance of any of these deductions at the corporate level, the payments to Adrian must be reasonable in amount. Payments deemed to be unreasonable in amount will be treated as corporate dividends to Adrian and nondeductible by Pigeon. However, to the extent the payments are reasonable in amount and deductible by Pigeon Corporation, the corporate tax is avoided on such amounts. The payments received by Adrian would be

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income (i.e., salary, interest, and rent) to him and taxed as such, but this would be the only tax incurred on such amounts (i.e., double taxation is avoided to the extent of any payments deductible by Pigeon).

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-07 - LO: 2-07

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 10 min.

103. Nancy is a 40% shareholder and president of Robin Corporation, a regular corporation. The board of directors of Robin has decided to pay Nancy a $75,000 bonus for the year based on her outstanding performance. The directors want to pay the $75,000 as salary, but Nancy would prefer to have it paid as a dividend. If Robin Corporation is in the 34% marginal tax bracket and Nancy is in the 33% marginal tax bracket irrespective of the treatment of the bonus, discuss which form of payment would be most beneficial for each party. (Ignore any employment tax considerations.)

ANSWER: Robin Corporation prefers treating the payment as salary, as a $75,000 deduction for such would provide the corporation with a tax savings of $25,500 [$75,000 (salary deduction) × 34% (marginal tax rate)]. If, instead, the payment were treated as a dividend, none of the $75,000 would deductible by Robin.

Nancy prefers treating the payment as a dividend, as a preferential tax rate of 15% would apply to the $75,000 and result in only $11,250 of tax. If, instead, the payment were treated as salary, Nancy would incur tax of $24,750 [$75,000 (salary) × 33% (marginal tax rate)]. Thus, Nancy would save $13,500 of tax if the payment were treated as a dividend instead of salary.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
CPET.SWFT.LO: 2-07 - LO: 2-07

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Analysis

OTHER: Time: 5 min.

104. Dawn is the sole shareholder of Thrush Corporation, a C corporation. In the current year, Thrush earned $350,000 and distributed $75,000 to Dawn. Kirk is the sole shareholder of Swallow Corporation, an S corporation. In the current year, Swallow earned $350,000 and distributed $75,000 to Kirk. Contrast the tax treatment of Thrush Corporation and Dawn with the tax treatment of Swallow Corporation and Kirk.

ANSWER: A C corporation is a separate taxable entity; thus, Thrush Corporation is taxed on the $350,000 of earnings. Income of a C corporation has no effect on the shareholders until such time a dividend is paid. When dividends are paid, shareholders must report dividend income on their tax returns. Thus, Dawn is taxed on $75,000 of dividends and the 20%/15%/0% preferential tax rate applies with respect to the dividends.

Generally, an S is not subject to an entity level Federal income tax. Instead, the corporation's income, gains, deductions, and losses are passed through to and reported by the shareholders

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on their tax returns. Thus, Swallow reports the $350,000 of earnings on its tax return (Form 1120S), but pays no income tax. Kirk is taxed on the $350,000 of earnings from Swallow on his individual income tax return (Form 1040). Distributions from S corporations are not taxable to the shareholder (to the extent of stock basis). Thus, Kirk is not taxed on the $75,000 distribution from Swallow.

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Analysis
OTHER: Time: 5 min.

105. What is a limited liability company? What favorable nontax and tax attributes does the LLC entity form offer taxpayers?

ANSWER: Similar to the corporate entity form, a limited liability company is an entity created under the laws of a specific state (or the District of the Columbia) and, pursuant to such laws, an LLC has the corporate feature of limited liability. This is the primary nontax characteristic that makes LLC status attractive. Other nontax attributes that are available with the LLC entity form include centralized management, continuity of life, and free transferability of ownership interests. Which of these nontax attributes are allowed will be dependent on the laws of the state of LLC organization. The principal tax advantage of the LLC entity form is the ability to avoid double taxation of the entity's profits. Most LLCs will be taxed as either partnerships (two or more owner LLCs) or sole proprietorships (one owner LLCs), although the check-the-box Regulations do provide the opportunity to have an LLC taxed as a corporation (including an S corporation).

POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-01 - LO: 2-01
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Knowledge
OTHER: Time: 5 min.

106. Explain the rules regarding the accounting periods available to corporate taxpayers.

ANSWER: In general, a corporate taxpayer may select a calendar year or a fiscal year for tax return reporting purposes. A newly formed corporation generally can select it's initial reporting period without having to obtain IRS consent. However, certain types of corporate taxpayers are subject to restrictions on their reporting period. In general, personal service corporations (PSCs) and S corporations are required to use the calendar year for tax reporting. Exceptions to this rule apply, and a fiscal year can be elected by a PSC (or S corporation), under any of the following conditions:

- A business purpose for the year can be demonstrated.
- The PSC tax year results in a deferral of not more than three months' income. An election under § 444 is required, and the PSC will be subject to the deduction limitations of § 280H. The corporation must pay the shareholder-employee's salary during the portion of the calendar year after the close of the fiscal year. In addition,

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the salary for that period must be at least proportionate to the employee's salary for the fiscal year. (For an S corporation electing a § 444 deferral, the required payments provision of § 7519 must be satisfied. See Chapter 12.)

- The PSC (or S corporation) retained the same year that was used for its fiscal year ending 1987, provided an election was made under § 444 and subject to the deduction limitations of § 280H (or § 7519, in the case of an S corporation).

POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 5 min.

107. Gerald, a cash basis taxpayer, owns 70% of the stock of Black Corporation, a calendar year, accrual basis C corporation. On December 31, 2016, Black accrued a bonus of $80,000 to Gerald, and paid the bonus to Gerald on January 6, 2017. When does Gerald report the bonus, and when does Black Corporation deduct the bonus? Would your answers change if Gerald was a 40% shareholder of Black?

ANSWER: Gerald is a more than 50% shareholder of Black Corporation; thus, the taxpayers are related parties under § 267. Gerald, a cash basis taxpayer, reports the salary income in 2017, the year of receipt. Under § 267, Black Corporation, an accrual basis taxpayer, cannot deduct the salary expense when accrued in 2016. Instead, Black's deduction for the bonus is in 2017, the year Gerald reports the salary as income.

If Gerald were a 40% shareholder, the § 267 related party rules would not apply to the bonus deduction. Instead, Black Corporation, an accrual basis taxpayer, deducts the bonus in 2016, the year of accrual. Gerald, a cash basis taxpayer, still reports the bonus as income in 2017, the year of receipt.

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Analysis
OTHER: Time: 5 min.

108. Briefly describe the accounting methods available for adoption by a C corporation.

ANSWER: In general, a C corporation must adopt the accrual method of accounting. However, there are several exceptions to this rule, and the following C corporations can use the cash method of accounting:

- Corporations engaged in the trade or business of farming or timber.
- Qualified personal service corporations.
- Corporations with average annual gross receipts of $5 million or less for the previous 3-

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year period.

There is a limitation on the use of the cash method by otherwise qualifying corporations that maintain inventories. In general, these corporations must use the accrual method in determining sales and cost of goods sold. However, corporations with average annual gross receipts of $1 million or less for the most recent 3-year period are not subject to the limitation. (Further, some corporations with average annual gross receipts of $10 million or less for the previous 3-year period also can avoid the limitation.)

Accrual method corporations are subject to a limitation on the deductibility of an accrued expenditure attributable to a cash method related party (e.g., a more-than-50% shareholder). In such cases, the corporation's deduction for the expenditure is deferred until the recipient includes the amount in income.

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPROG: Reflective Thinking
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Knowledge
OTHER: Time: 5 min.

109. Contrast the tax treatment of capital gains and losses of C corporations with that of individual taxpayers.
ANSWER: The definition of capital assets is the same for both corporate and individual taxpayers. Also, both types of taxpayers net short- and long-term gains and losses to arrive at a net capital gain or loss. In the case of a net capital gain, individual taxpayers receive a preferential tax rate (0%/15%/20%) with respect to LTCGs but corporations do not receive any preference as to LTCG tax rates. In the case of a net capital loss, individual taxpayers can deduct up to $3,000 of net capital loss against ordinary income in the current year but corporations cannot deduct any amount of a net capital loss in the current year. Individual taxpayers carry forward capital losses indefinitely, with such losses retaining their character as short term or long term. Corporate taxpayers carry capital losses back three years and forward five years, and such losses are treated as STCL in such years.
POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
CPET.SWFT.LO: 2-07 - LO: 2-07
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Evaluation
OTHER: Time: 10 min.

110. Briefly describe the charitable contribution deduction rules applicable to C corporations.
ANSWER: Tax year of deduction: In general, a charitable contribution is deductible only in the year the gift is made. For an accrual basis corporation, however, a charitable contribution can be deducted in the current year for a contribution that is (1) approved by the corporation's board of directors by the end of such year and (2) paid on or before the fifteenth day of the fourth month of the next year.

Amount of contribution: In addition to cash gifts, property contributions to qualified

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charitable organizations are also deductible. For property that is depreciated (fair market value less than basis), the amount of the contribution is the property's fair market value. For property that is appreciated (fair market value greater than basis), the amount of the contribution depends on whether the property is "capital gain property" or "ordinary income property." Capital gain property is property that, if sold, would result in a long-term capital gain or § 1231 gain. A contribution of capital gain property generally results in a deductible amount equal to the property's fair market value. If the capital gain property is tangible personal property and the charitable organization's use of the property is unrelated to its exempt function, the amount of the contribution is equal to the property's basis. (Contributions of capital gain property to certain private foundations are similarly limited to the property's basis.) Ordinary income property is property that, if sold, would not result in a long-term capital gain or § 1231 gain. Typically, the deduction for a contribution of ordinary income property is equal to the property's basis. However, charitable contributions of certain inventory property by corporations can result in an enhanced deduction amount. For such inventory property, the deductible amount is equal to the lesser of (1) the sum of the property's basis plus 50% of the appreciation on the property or (2) twice the property's basis.

Annual limitation on deduction: A corporate taxpayer's charitable deduction is limited to 10% of taxable income (determined without regard to the charitable contribution deduction, any net operating loss carryback or capital loss carryback, dividends received deduction, and domestic production activities deduction). Any contributions in excess of the 10% limitation may be carried forward for five years. In any tax year for which there is a charitable contribution carryover, current year's gifts are applied against the 10% limitation first, with carryover amounts deducted in order of time.

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 10 min.

111. Briefly discuss the requirements for the dividends received deduction.

ANSWER: The dividends received deduction (DRD) is available to C corporations with respect to dividends received from domestic corporations. The amount of the DRD is generally equal to 70% (for stock ownership of less than 20%) or 80% (for stock ownership of 20% or more but less than 80%) of the dividends received. A limitation applies if the applicable percentage (70% or 80%) of taxable income (computed without regard to the DRD, NOL deduction, domestic production activities deduction, and capital loss carryback) is less than the normal DRD amount. However, the taxable income limitation does not apply if the normal DRD amount creates or increases an NOL. (For stock ownership interests of 80% or more, the applicable DRD percentage is 100% and the taxable income limitation does not apply.)

Two additional limitations apply to the DRD. First, no DRD is allowed unless the corporation has held the stock for more than 45 days. Second, the amount of the DRD is reduced by the percentage of the investment in the stock that is debt financed. This reduction in the DRD cannot exceed that amount of the interest expense deduction allocable to the dividend.

POINTS: 1
DIFFICULTY: Moderate

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LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Evaluation
OTHER: Time: 10 min.

112. In connection with the deduction for startup expenditures, comment on the following:

a. Qualifying expenditures.
b. Election process.
c. Amount of deduction.

ANSWER:

a. "Startup expenditures" are expenses incurred after the organization of a trade or business but before such trade or business has begun operations. Examples of startup expenditures include rent, payroll, accounting, advertising, insurance, utilities, and other operating expenses associated with the pre-opening of a trade or business.
b. A corporation is deemed to have made the election to amortize startup expenditures for the taxable year in which the corporation begins business. The startup expenditures deduction is claimed on the corporation's return for such taxable year without any separate statement or specific identification of the deduction. If a corporation wants to forgo the deduction of startup expenditures, a separate statement to that effect should accompany the corporation's tax return for its first taxable year.
c. In general, startup expenditures are amortized over a 180-month period beginning with the month the corporation begins business. However, the first $5,000 of startup expenditures is expensed in the first taxable year, with the remaining amount of expenditures amortized over the 180-month period. The $5,000 expensing amount is reduced to the extent startup expenditures exceed $50,000 (i.e., there is no immediate expensing if startup expenditures equal or exceed $55,000).

POINTS: 1
DIFFICULTY: Moderate
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-06 - LO: 2-06
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Evaluation
OTHER: Time: 10 min.

113. What is the annual required estimated tax payment for a C corporation? What are the rules regarding payment of the estimated tax?

ANSWER: Estimated tax payments are required if the corporation's tax liability is expected to be $500 or more. The required annual payment (which includes estimated AMT liability) is the lesser of (1) 100% of the corporation's tax for the current year or (2) 100% of the corporation's tax for the preceding year. Estimated payments are made quarterly, due on or before the 15th day of the 4th, 6th, 9th, and 12th month of the taxable year. Underpayment of estimated tax penalty can be avoided if the quarterly payments are filed timely and equal to the corporation's tax liability for the prior year (or tax liability computed on an annualized method). A corporation with taxable income of $1 million or more in any of its three preceding years can use the prior year's tax liability for computing only the first installment

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payment. In such cases, the corporation's second installment payment must include any shortfall resulting from using the prior year's liability (instead of the current year's liability) for the first installment.

POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-02 - LO: 2-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Comprehension
OTHER: Time: 5 min.

114. What is the purpose of Schedule M-3? Which corporations are required to file Schedule M-3?

ANSWER: Schedule M-3 was created, in part, in response to financial reporting scandals, such as Enron and WorldCom. Schedule M-3 requires corporations to report much more information regarding the differences between financial net income (loss) and taxable income than is required of Schedule M-1. This greater transparency should allow the IRS to more easily identify corporations that engage in aggressive tax practices, as those transactions generally result in book/tax differences that must be reported on Schedule M-3. Entities with total assets of $10 million or more must file Schedule M-3 (in lieu of Schedule M-1). The financial figures (e.g., amount of total assets, net income or loss) required of the Schedule M-3 are drawn from the corporation's Form 10-K. If Form 10-K is not filed, then another financial source, e.g., certified financial statements, is used.

POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: CPET.SWFT.LO: 2-03 - LO: 2-03
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Reporting
KEYWORDS: Bloom's: Knowledge
OTHER: Time: 5 min.

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