

**Tax Return Problem 1**  
**Accounting 446**  
**Spring 2000**

Lector Corporation manufactures Universal Serial Bus (USB) hubs for desktop computers. It makes two lines of hubs 4 and 7 port. The company has been manufacturing the hubs since Microsoft began offering its Windows 98 operating system on most desktop computers. Three brothers from Nebraska own the company and started the company as a result of listening to a lecture at UNL about new and evolving technologies. Their interest in technology was fed by the extensive use of fiber optic cables to transmit data between diverse geographic locations within and outside Nebraska.

The three brothers Rod, Robert, and Dan each contributed a substantial amount of cash to the business as well as borrowing an additional \$200,000 from the Harris Trust Bank of Chicago. Robert is the primary shareholder and owns 38 percent of the company's stock. Dan and Rod own 29 percent and 33 percent respectively. Each brother is an officer in the corporation but each contributes time to the manufacturing process. Their salary for time in the manufacturing process is billed as direct labor.

The brothers have received help filing their tax return from an older brother who claims to know something about taxes but the return is becoming more difficult for him to complete on time and he is occupied with projects of his own (he has a hot sauce manufacturing facility in Chicago). Therefore Lector Corporation (the brothers) has come to you for help in filing their current year's tax return.<sup>1</sup> The brothers have put together the following information set to help you with your task.

Gross Sales	\$3,250,000
Sales Returns	\$135,000
Dividends Received (2% ownership)	\$15,000
Interest on --	
State Bonds	\$5,000
IBM Corporation	\$6,000

<sup>1</sup> Use the spreadsheet provided to complete this project.

Premiums on Life Insurance Policies <sup>2</sup>	\$9,500
Compensation of Officers <sup>3</sup>	\$300,000
Salaries and Wages Indirect	\$5,000
Repairs	\$800
Rental Expense	\$20,200
Taxes	\$15,000
Interest Expense	\$37,200
Contributions	
Deductible	\$35,000
Other	\$500
Depreciation-indirect <sup>4</sup>	\$4,000
Advertising	\$80,000
Other Expenses	\$88,300

Lector analyzed its retained earnings and the following appeared in the account per books.

	Debit	Credit
Balance 01/01,		\$368,000
Dividends Paid	\$75,000	
Refund of 1997 taxes		\$20,000

Lector provides you with the following information concerning its cost of goods sold.

Beginning Inventory <sup>5</sup>	\$126,000
Ending Inventory	\$298,400
Purchases	\$1,127,100
Cost of Labor	\$402,000 <sup>6</sup>
Other costs	\$123,300 <sup>7</sup>

<sup>2</sup> Insurance Policies of \$250,000 have been taken out on all three brothers.

<sup>3</sup> Salaries: Robert \$115,000, Rod \$100,000, and Dan \$85,000. This does not include the salaries billed as direct labor.

<sup>4</sup> Total tax depreciation for the year is \$17,500

<sup>5</sup> Lector values its inventory using lower of cost or market.

<sup>6</sup> This also includes 30 percent of the amount listed as officer compensation.

<sup>7</sup> This represents costs included in factory overhead, including depreciation of \$12,400 on assets used to produce the hubs. This depreciation amount is the same for book and tax.

Additional Information:<sup>8</sup>

Account	Bal 01/01
Cash	\$14,700
Accounts Receivable	\$98,400
Inventory	\$126,000
Tax-Exempt Securities	\$100,000
Other Assets	\$26,300
Buildings and other Depreciable Assets	\$372,400
Accumulated Depreciation	\$88,300
Long-term Investment-I BM	\$100,000
Land	\$20,000
Other assets	\$14,800
Accounts Payable	\$28,500
Mortgages <1 year	\$4,300
Other current liabilities	\$6,800
Mortgages >1 year	\$176,700
Capital Stock	\$200,000
Retained Earnings- Appropriated	\$80,000
Retained Earnings Unappropriated	\$288,000

Required:

Complete a form 1120 for Lector Corporation. You may use the cash account to accumulate any funds you are unable to identify given the information provided.

Lector reduced its outstanding mortgage and notes to \$170,700 during the year and the amount listed as due in less than one year remains at \$4,300 at year end. The following table provides end of year balances for some of the corporate book accounts. The corporation made \$120,000 of estimated tax payments during the year.

Account	Bal 12/31
Cash	\$93,714
Accounts Receivable	\$98,400
Inventory	\$298,400
Tax-Exempt Securities	\$100,000
Other Assets-current	\$26,300
Land	\$20,000
Long-term Investment-I BM	\$100,000
Other assets-Long-term	\$14,800
Accounts Payable	\$28,500
Other current liabilities	\$6,800
Capital Stock	\$200,000

<sup>8</sup> The corporation uses the accrual method of accounting to keep its books for tax and book purposes

