

Chapter C5

Other Corporate Tax Levies

Problems

C5-33 a. See table below. If Willis Corporation is formed in 2000, it will qualify for the exemption in its initial year without regard to its gross receipts because it is not aggregated with other corporations and because it is not a continuation of a predecessor corporation. In its second year (2001), its gross receipts for the first year of \$2.5 million are below the \$5 million threshold, and it qualifies for the exemption. In its third year (2002), its average gross receipts for the first two years are \$3.75 million ($\$7.5 \text{ million} \div 2$), and it qualifies for the exemption. In its fourth year (2003), its average gross receipts in the first three years (2000-2002) are \$4.5 million ($\$13.5 \text{ million} \div 3$), and it qualifies for the exemption. In its fifth year (2004), its average gross receipts for years 2 through 4 are \$6.667 million ($\$20.0 \text{ million} \div 3$), and it qualifies for the exemption. In its sixth year (2005), its average gross receipts for the preceding three-year period are \$8.333 million ($\$25.0 \text{ million} \div 3$), and it fails to qualify for the exemption. Failing the gross receipts test in 2005 means that Willis Corporation is potentially subject to the corporate alternative minimum tax for the current year and all future years. Willis Corporation is unable to reclaim its AMT exemption once it grows large enough to fail the gross receipts test.

The following table summarizes the application of the gross receipts test for each tax year.

Tax Year	Gross Receipts	Average Gross Receipts	Gross Receipts Ceiling	Status
2000	\$ 2,500,000	N/A	N/A	OK
2001	\$ 5,000,000	\$2,500,000	\$5,000,000	OK
2002	\$ 6,000,000	\$3,750,000	\$7,500,000	OK
2003	\$ 9,000,000	\$4,500,000	\$7,500,000	OK
2004	\$10,000,000	\$6,666,667	\$7,500,000	OK
2005	Not known	\$8,333,333	\$7,500,000	Fails Test

pp. C5-2 through C5-4.

C5-34 a.	Taxable income	\$ 700,000
	Plus: Tax preference items	300,000
	Positive AMTI adjustments	<u>600,000</u>
	AMTI	\$1,600,000
b.	Minus: Statutory exemption	-0-
	Tax base	\$1,600,000
	Times: Tax rate	<u>x 0.20</u>

	Tentative minimum tax	\$ 320,000
c.	Minus: Regular tax amount	(238,000) ^a
d.	AMT liability	\$ 82,000

^a\$700,000 x 0.34 = \$238,000.

pp. C5-3 through C5-10.

C5-35

	Depreciation for:		
<u>Year</u>	<u>Taxable Income (a)</u>	<u>AMTI (b)</u>	<u>ACE (c)</u>
1993	\$1,429 ^a	\$ 625 ^b	\$417 ^c
1994	2,449	1,172	833
1995	1,749	1,025	833
1996	1,249	897	833
1997	893	785	833
1998	892	733	833
1999	893	733	834
2000	446	733	833
2001	-0-	733	834
2002	-0-	733	833
2003	-0-	733	834
2004	-0-	733	833
2005	-0-	365	417

^a\$10,000 x MACRS percentage using 200% declining balance method, half-year convention, and seven-year recovery period.

^b\$10,000 x MACRS percentage using 150% declining balance method, half-year convention, and 12-year class life.

^c\$10,000 x MACRS percentage using straight-line method, half-year convention, and 12-year class life.

If the property were placed in service in 1996, there would be no separate ACE depreciation calculation. The separate ACE depreciation calculation was terminated for property placed in service after December 31, 1993.

Comment: If the property were instead placed in service in 1999 or a later year the same recovery period will be used for regular MACRS depreciation and AMTI depreciation. An election also is available to use the 150% DB method for regular tax purposes, which is the same method used to compute AMTI depreciation. pp. C5-6, C5-7, and C5-9.

C5-36 a.

Taxable income calculation:		
<u>Year</u>	<u>Depr. Calculation</u>	<u>Depr. Amount</u>
1993	\$10,000 x 0.1429	\$ 1,429
1994	\$10,000 x 0.2449	2,449

1995	\$10,000 x 0.1749	1,749
1996	\$10,000 x 0.1249	1,249
1997	\$10,000 x 0.0893	893
1998	\$10,000 x 0.0893	892
1999	\$10,000 x 0.0893	893
2000	\$10,000 x 0.0446	446
Total		<u>\$10,000</u>

Taxable income gain = \$5,000 - (\$10,000 - \$10,000) = \$5,000.

AMTI calculation:

<u>Year</u>	<u>Depr. Calculation</u>	<u>Depr. Amount</u>
1993	\$10,000 x 0.0625	\$ 625
1994	\$10,000 x 0.1172	1,172
1995	\$10,000 x 0.1025	1,025
1996	\$10,000 x 0.0897	897
1997	\$10,000 x 0.0785	785
1998	\$10,000 x 0.0733	733
1999	\$10,000 x 0.0733	733
2000	\$10,000 x 0.0733 x 0.50	367
Total		<u>\$6,337</u>

AMTI gain = \$5,000 - (\$10,000 - \$6,337) = \$1,337.

ACE calculation:

A separate ACE depreciation calculation is required since the asset was acquired before 1994.

<u>Year</u>	<u>Depr. Calculation</u>	<u>Depr. Amount</u>
1993	\$10,000 x 0.0417	\$ 417
1994	\$10,000 x 0.0833	833
1995	\$10,000 x 0.0833	833
1996	\$10,000 x 0.0833	833
1997	\$10,000 x 0.0833	833
1998	\$10,000 x 0.0833	833
1999	\$10,000 x 0.0833	833
2000	\$10,000 x 0.0833 x 0.50	417
Total		<u>\$5,832</u>

ACE gain = \$5,000 - (\$10,000 - \$5,832) = \$832.

b. To arrive at the AMTI adjustment, the excess of the taxable income depreciation over the AMTI depreciation is a positive adjustment to taxable income. If AMTI depreciation exceeds taxable income depreciation, the excess of the AMTI depreciation over the taxable income depreciation is a negative adjustment to taxable income to arrive at AMTI.

To arrive at the ACE adjustment, the excess of the AMTI depreciation over the ACE depreciation is a positive adjustment to AMTI. If ACE depreciation exceeds AMTI depreciation, the excess of the ACE depreciation over the AMTI depreciation is a negative adjustment to AMTI to arrive at ACE.

The following table reports the annual adjustments to arrive at AMTI and ACE for the years in question:

Year	T/I Depr.	AMTI Depr.	AMTI Adj.	ACE Depr.	ACE Adj.
1993	\$1,429	\$ 625	\$ 804	\$ 417	\$ 208
1994	2,449	1,172	1,277	833	339
1995	1,749	1,025	724	833	192
1996	1,249	897	352	833	64
1997	893	785	108	833	(48)
1998	892	733	159	833	(100)
1999	893	733	160	833	(100)
2000	<u>446</u>	<u>367</u>	<u>79</u>	<u>417</u>	<u>(50)</u>
Total	<u>\$10,000</u>	<u>\$6,337</u>	<u>\$3,663</u>	<u>\$ 5,832</u>	<u>\$ 505</u>

The gains on the sale of the depreciable asset for taxable income, AMTI, and ACE purposes are:

Taxable income: \$5,000
 AMTI: 1,337
 ACE: 832

The AMTI adjustment is a \$3,663 negative adjustment to taxable income to arrive at AMTI. The adjustment is the difference between the \$5,000 taxable income gain and the \$1,337 AMTI gain. The ACE adjustment is a \$505 negative adjustment to AMTI to arrive at ACE. The adjustment is the difference between the \$1,337 AMTI gain and the \$832 ACE gain. pp. C5-6, C5-7, and C5-9.

C5-37	<u>1996</u>	<u>1997</u>	<u>1998</u>	<u>1999</u>	<u>2000</u>
ACE	\$500	\$500	\$500	\$500	\$(500)
Minus: Pre-adjustment AMTI	(100)	600	900	-0-	(300)
Difference	<u>\$600</u>	<u>\$100</u>	<u>\$(400)</u>	<u>\$500</u>	<u>\$(200)</u>
ACE adjustment ^a	<u>\$450</u>	<u>\$(75)</u>	<u>\$(300)</u>	<u>\$375</u>	<u>\$(150)</u>
Preadjustment AMTI	(100)	600	900	-0-	(300)
+/- ACE adjustment	<u>450</u>	<u>(75)</u>	<u>(300)</u>	<u>375</u>	<u>(150)</u>
AMTI	<u>\$350</u>	<u>\$525</u>	<u>\$600</u>	<u>\$375</u>	<u>\$(450)</u>

^a[(ACE - Pre-adjustment AMTI) x 0.75], or (Difference x 0.75).

C5-39 a.	Taxable income	\$210,000
	Plus/Minus: Adjustments:	
	1. Depreciation (\$100,000 - \$75,000)	25,000
	2. Basis adjustment (Sec. 1245 gain)	(9,000)
	3. ACE ^a	<u>190,500</u>
	AMTI	\$416,500
b.	Minus: Statutory exemption	<u>-0-</u>
	Tax base	\$416,500
	Times: Tax rate	<u>x 0.20</u>
	Tentative minimum tax	\$ 83,300
	Minus: Regular tax ^b	<u>(65,150)</u>
	AMT liability	<u>\$ 18,150</u>

^a(\$480,000 - \$226,000) x 0.75 = \$190,500.

^b(\$22,250 tax on first \$100,000) + (\$110,000 x 0.39) = \$65,150.

c. The minimum tax credit is \$18,150, which carries forward indefinitely.

pp. C5-4 through C5-13.

C5-47 Under the old rules (sales before December 18, 1999), the reporting of the gain for taxable income, AMTI, and ACE purposes produces timing differences. The gains recognized under the old rules in the six years covered by the installment sale contract are as follows:

Year	Taxable Income Gain Inclusion	AMTI Gain Inclusion	ACE Gain Inclusion
Current [C]	\$ 180,000*	\$ 180,000*	\$1,620,000***
C + 1	324,000***	324,000***	(324,000)***
C + 2	324,000	324,000	(324,000)
C + 3	324,000	324,000	(324,000)
C + 4	324,000	324,000	(324,000)

C + 5	<u>324,000</u>	<u>324,000</u>	<u>(324,000)</u>
Total	<u>\$1,800,000</u>	<u>\$1,800,000</u>	<u>\$ -0-</u>

* \$300,000 collection x (\$1,800,000 gain ÷ \$3,000,000 sales price)

** \$1,800,000 - \$180,000 inclusion in AMTI = \$1,620,000

*** \$540,000 collection x (\$1,800,000 gain ÷ \$3,000,000 sales price)

In the first year (Year C), the gain inclusion for taxable income and AMTI purposes are the same. The \$180,000 of gain produces a \$61,200 increase in the income tax liability and a \$36,000 increase in the tentative minimum tax. The net result is a \$25,200 additional income tax liability that can reduce an existing AMT liability or reduce the effects of the ACE adjustment.

The \$1,620,000 ACE installment gain inclusion in the first year produces a \$1,215,000 (0.75 x \$1,620,000) ACE adjustment. The ACE adjustment increases the tentative minimum tax amount by \$243,000 (\$1,215,000 x 0.20). The maximum AMT owed by the corporation as a result of the ACE adjustment is \$243,000 - \$25,200 income tax increase, or \$217,800. This liability could be reduced further if the firm is in a tax position where the income taxes owed on transactions other than the installment sale exceed the tentative minimum tax. pp. C5-3 and C5-5 through C5-13.

The amount of any AMT liability incurred as a result of the timing differences produced by the installment sale is available as a minimum tax credit carryover that can reduce the income tax liability incurred in subsequent years.

In the later years (the C + years), the negative ACE gain inclusion of \$324,000 produces a negative ACE adjustment of \$243,000 (\$324,000 x 0.75). This negative adjustment reduces the annual tentative minimum tax by \$48,600 (\$243,000 x 0.20).

Delaying the sale to 2000 causes the new installment sale rules to apply when determining taxable income, AMTI, and ACE. The corporation reports the entire gain in the sale year for all three tax calculations. No timing differences result because the gain is fully included in taxable income, AMTI, and ACE. The income tax levy on the sale is \$612,000 (\$1,800,000 x 0.34). The AMTI gain inclusion increases the tentative minimum tax by \$360,000 (\$1,800,000 x 0.20). If the corporation has a possible AMT problem, the additional income tax paid on the installment sale over the increase in the tentative minimum tax provides a \$252,000 (\$612,000 - \$360,000) cushion against owing the AMT. The ACE inclusion does not produce a tax increase because the same gain is included in both ACE and AMTI.

Year	Taxable Income Gain Inclusion	AMTI Gain Inclusion	ACE Gain Inclusion
Current	\$1,800,000	\$1,800,000	\$1,800,000
C + 1	-0-	-0-	-0-
C + 2	-0-	-0-	-0-
C + 3	-0-	-0-	-0-
C + 4	-0-	-0-	-0-
C + 5	-0-	-0-	-0-
Total	<u>\$1,800,000</u>	<u>\$1,800,000</u>	<u>\$1,800,000</u>

$$\frac{\text{PHCI}}{\text{AOGI}} = \frac{40,000 + \$60,000}{\$75,000 + \$40,000 + \$60,000} = .571 \text{ (income test not met)}$$

pp. C5-3 and C5-5 through C5-13

C5-49 100% of current year liability alternative:

Regular tax	\$120,000
Plus: AMT	<u>60,000</u>
Total taxes	\$180,000
Estimated percentage	<u>x 1.00</u>
Minimum payment based on current year liability (1)	<u>\$180,000</u>
100% of prior year liability alternative (2)	<u>\$200,000</u>
Required annual estimated tax payments [lesser of (1) or (2)]	<u>\$180,000</u>
Quarterly estimated tax payment (\$180,000 ÷ 4)	<u>\$ 45,000</u>

p. C5-36.

C5-50 a. Regular tax	\$120,000
Plus: AMT	<u>25,000</u>
Total taxes	\$145,000
Estimated tax payments (\$23,000 x 4)	<u>(92,000)</u>
Tax due with tax return on March 15, 2001	<u>\$ 53,000</u>

b. Dallas must have made payments equal to the lesser of (1) 100% of the 1999 total tax liability (\$100,000) or (2) 100% of the 2000 tax liability shown on its return (\$145,000 x 1.00 = \$145,000). Therefore, Dallas is liable for a penalty on \$2,000 [(\$100,000 x 0.25) - \$23,000] of underpaid taxes for each quarter of 2000. The amount of the penalty can be determined by completing Form 2220. p. C5-36.

C5-52 a.

Total Corporation is not a PHC because only the stock ownership test has been met.

- b. AIR = \$100,000 - \$40,000 = \$60,000
 OGI = \$100,000 + \$14,000 + \$6,000 = \$120,000
 AOGI = \$60,000 + \$14,000 + \$6,000 = \$80,000
 50% test: \$60,000/\$80,000 = 0.75 (test satisfied)
 10% test: (\$14,000 + \$6,000) - (0.10 x \$120,000) = \$8,000
 Dividends of \$8,000 need to be paid, but Total paid no dividends. So the second test is not satisfied.

Because only one of the two tests is satisfied, the adjusted income from rents is included in PHCI. As a result, the income and stock ownership tests are met.

$$\frac{\text{PHCI}}{\text{AOGI}} = \frac{60,000 + \$14,000 + \$6,000}{\$80,000} = 100\%$$

Total Corporation is a PHC.

c. The dividends paid exceed the minimum dividend amount determined in Part b for the 10% test. Both the 50% and 10% tests are met, so the adjusted income from rents is excluded from PHCI. PHCI (\$14,000 + \$6,000 = \$20,000) is now 25% of AOGI (\$80,000). Since only the stock ownership test is met, Total Corporation is not a PHC. pp. C5-15 through C5-20.

C5-53 a.	\$22,250 (tax on first \$100,000) + (\$100,000 x 0.39) = \$61,250	
b.	Taxable income	\$200,000
	Plus: Dividends-received deduction (\$50,000 x 0.80)	40,000
	Minus: Federal income taxes	(61,250)
	Dividends-paid deduction	<u>(75,000)</u>
	Undistributed personal holding company income	<u>\$103,750</u>
	PHC Tax = 0.396 x \$103,750 = \$41,085	

c. Before Moore Corporation files its tax return, it can eliminate its PHC tax liability by paying a consent dividend or a combination consent dividend and throwback dividend (the throwback dividend is limited to 20% of the \$75,000 actual dividends paid, or \$15,000). After it files the return, Moore Corporation can pay a deficiency dividend in the amount of \$103,750, which will eliminate the PHC tax liability but not the interest and penalties owed. pp. C5-20 through C5-23, C5-34 through C5-36.

C5-55 a.	Taxable income	\$250,000
	Plus: Charitable contribution carryover deducted currently	5,000
	Dividends-received deduction	30,000
	Minus: Net capital gain	\$50,000
	Minus: Federal income taxes ^a	<u>(19,500)</u>
	Dividends-paid deduction	(40,000)
	Federal income taxes	<u>(80,750)</u>
	Undistributed personal holding company income	<u>\$133,750</u>
	PHC Tax = 0.396 x \$133,750 = \$52,965	
	^a \$50,000 x 0.39 = \$19,500	

b. Before Victor Corporation files the tax return, it can eliminate its PHC tax liability by paying a consent dividend or a combination consent dividend and throwback dividend (the throwback dividend is limited to 20% of the \$40,000 actual dividends, or \$8,000). After it files the return, Victor Corporation can pay a deficiency dividend of \$133,750, which will eliminate the PHC tax liability but not the interest and penalties owed. pp. C5-20 through C5-23, C5-34 through C5-36.

C5-56 a. The IRS agent will likely argue that the sinking fund no longer is needed to repay the debt obligation. This amount is now available to be paid as a dividend and is presently invested in assets unrelated to operating activities and earning portfolio income. The lack of definite corporate

plans at year-end regarding the use of these funds to purchase operating assets could hurt the company. The corporation might argue that temporary investments in stocks and bonds are not necessarily an indication that an unreasonable accumulation of earnings exists with a tax avoidance motive. An argument can be made that a general plan to purchase operating assets exists at year-end, and that the corporation was in the process of reviewing specific acquisition possibilities. The corporation needs to document some of these plans.

b. The IRS agent will likely argue that the loans to Tess at a below-market interest rate act as a substitute for a dividend payment. Their use and size (i.e., equal to one year's net income) indicates a possible accumulated earnings tax problem and a tax avoidance motive. The agent also might point to facts, such as lack of any documentation regarding the loans, lack of enforcement of due dates for the loans, etc., that might exist as further evidence of their being a constructive dividend. The corporation might argue that the loans are temporary in nature and were made only because excess funds were available while the corporation waited to carry out other plans that can be documented. A plan for repayment of the remaining loans and the use of the amounts so received in subsequent business activities might help.

c. The IRS agent will argue that the corporation's substantial investment portfolio is an indication of a possible excess earnings accumulation. The corporate level investments are a substitute for paying dividends and having Tess make personal investments. The corporation needs to produce definite plans for using a large portion of the funds in operating activities in the near future, or to carry out other business-related activities.

d. The IRS agent will argue that loans between members of the controlled group, all owned by Tess, at a below-market interest rate is an indication of a possible excess earnings accumulation being used for Tess's benefit. The making of the loans is a substitute for paying dividends and having Tess make personal loans or additional capital contributions to her other corporations. The corporation might argue that the loans are temporary and then show that written evidence of the indebtedness (e.g., a note) exists and that timely payment of the note principal when due has occurred. Definite plans for using the money as part of Adobe's operating activities would be helpful. pp. C5-25 through C5-29.