

Problems: taxation of business

[Business](#)



Corporate Operations

Problems

44. (LO1) LNS corporation reports a book income of \$2, 000, 000. Included in the \$2, 000, 000 is \$15, 000 of tax-exempt interest income. LNS reports \$1, 345, 000 in ordinary and necessary business expenses. What is the LNS corporation's taxable income for the year?

45. (LO1) ATW corporation currently uses the FIFO method of accounting for its inventory for book and tax purposes. Its beginning inventory for the current year was \$8, 000, 000. Its ending inventory for the current year was \$7, 000, 000. If ATW had been using the LIFO method of accounting for its inventory, its beginning inventory would have been \$7, 000, 000 and its ending inventory would have been \$5, 500, 000. Assume ATW corporation's marginal tax rate is 34 percent.

- a. How much more in taxes did ATW corporation pay for the current year because it used the FIFO method of accounting for inventory than it would have paid if it had used the LIFO method? b. Why would ATW use the FIFO method of accounting if doing so causes it to pay more taxes on a present value basis? (Note that the tax laws don't allow corporations to use the LIFO method of accounting for inventory unless they also use the LIFO method of accounting for inventory for book purposes.)

46. (LO1) ELS corporation is about to begin its sixth year of existence. Assume that ELS reported gross receipts for each of its first five years of existence for Scenarios A, B, and C as follows:

- a. In what years is ELS allowed to use the cash method of accounting under Scenario A?
- b. In what years are ELS allowed to use the cash method of accounting under Scenario B?
- c. In what years is ELS allowed to use the cash method of accounting under Scenario C?

47. (LO2) On its year 1 financial statements, Seatax Corporation, an accrual method taxpayer, reported federal income tax expense of \$570, 000. On its year 1 tax return, it reported a tax liability of \$650, 000. During year 1, Seatax made estimated tax payments of \$700, 000. What book-tax difference, if any, associated with its federal income tax expense should Seatax have reported when computing its year 1 taxable income? Is the difference favorable or unfavorable? Is it temporary or permanent?

48. (LO2) Assume Maple Corp. has just completed the third year of its existence (year 3). The table below indicates Maple's ending book inventory for each year and the additional §263A costs it was required to include in its ending inventory. Maple immediately expensed these costs for book purposes.

- a. What book-tax difference associated with its inventory did Maple report in year 1? Was the difference favorable or unfavorable? Was it permanent or temporary?
- b. What book-tax difference associated with its inventory did Maple report in year 2? Was the difference favorable or unfavorable? Was it permanent or temporary?

- c. What book-tax difference associated with its inventory did Maple report in year 3? Was the difference favorable or unfavorable? Was it permanent or temporary?

49. (LO2) JDog corporation owns stock in Oscar Inc. JDog received a \$10,000 dividend from Oscar Inc. What temporary book-tax difference associated with the dividend will JDog report for the year in the following alternative scenarios (income difference only—ignore the dividends received deduction)?

- a. JDog owns 5 percent of the Oscar Inc. stock. Oscar's income for the year was \$500,000.
 - b. JDog owns 40 percent of the Oscar Inc. stock. Oscar's income for the year was \$500,000.
50. (LO2) On July 1 of year 1, Riverside Corp. (RC), a calendar-year taxpayer, acquired the assets of another business in a taxable acquisition.

50. When the purchase price was allocated to the assets purchased, RC determined it had purchased \$1,200,000 of goodwill for both book and tax purposes. At the end of year 1, the auditors for RC determined that the goodwill had not been impaired during the year. In year 2, however, the auditors concluded that \$200,000 of the goodwill had been impaired, and they required RC to write down the goodwill by \$200,000 for book purposes.

- a. What book-tax difference associated with its goodwill should RC report in year 1? Is it favorable or unfavorable? Is it permanent or temporary?

- b. What book-tax difference associated with its goodwill should RC report in year 2? Is it favorable or unfavorable? Is it permanent or temporary?

51. (LO2) Assume that on January 1, year 1, ABC Inc. issued 5, 000 stock options with an estimated value of \$10 per option. Each option entitles the owner to purchase one share of ABC stock for \$25 a share (the per-share price of ABC stock on January 1, year 1, when the options were granted). The options vest 50 percent at the end of the day on December 31, year 1, and 50 percent at the end of the day on December 31, year 2. All 5, 000 stock options were exercised in year 3 when the ABC stock was valued at \$31 per share. Identify ABC's year 1, 2, and 3 tax deductions and book-tax differences (indicate whether permanent and/or temporary) associated with the stock options under the following alternative scenarios:

- a. The stock options are incentive stock options and ASC 718 (the codification of FAS 123R) does not apply to the options.
- b. The stock options are nonqualified stock options and ASC 718 does not apply to the options.
- c. The stock options are incentive stock options and ASC 718 applies to the options.
- d. The stock options are nonqualified stock options and ASC 718 applies to the options.

52. (LO2) Assume that on January 1, year 1, XYZ Corp. issued 1, 000 nonqualified stock options with an estimated value of \$4 per option. Each option entitles the owner to purchase one share of XYZ stock for \$14 a share

(the per-share price of XYZ stock on January 1, year 1, when the options were granted). The options vest 25 percent a year (on December 31) for four years (beginning with year 1). All 500 stock options that had vested to that point were exercised in year 3 when the XYZ stock was valued at \$20 per share. No other options were exercised in year 3 or year 4. Identify XYZ's year 1, 2, 3, and 4 tax deductions and book-tax difference (identify as permanent and/or temporary) associated with the stock options under the following alternative scenarios:

- a. ASC 718 does not apply to the stock options.
- b. ASC 718 applies to the stock options.

53. (LO2) What book-tax differences in year 1 and year 2 associated with its capital gains and losses would ABD Inc. report in the following alternative scenarios? Identify each book-tax difference as favorable or unfavorable and as permanent or temporary.

- e. Answer for year 6 only.
- f. Answer for year 7 only.

54. (LO2) What book-tax differences in year 1 and year 2 associated with its capital gains and losses would DEF Inc. report in the following alternative scenarios? Identify each book-tax difference as favorable or unfavorable and as permanent or temporary.

- a. In year 1, DEF recognized a loss of \$15, 000 on land that it had held for investment. In year 1, it also recognized a \$30, 000 gain on equipment it had purchased a few years ago. The equipment sold for \$50, 000 and had an adjusted basis of \$20, 000. DEF had deducted

\$40, 000 of depreciation on the equipment. In year 2, DEF recognized a capital loss of \$2, 000.

- b. In year 1, DEF recognized a loss of \$15, 000 on land that it had held for investment. It also recognized a \$20, 000 gain on equipment it had purchased a few years ago. The equipment sold for \$50, 000 and had an adjusted basis of \$30, 000. DEF had deducted \$15, 000 of tax depreciation on the equipment.

55. (LO2) MWC Corp. is currently in the sixth year of its existence (2011). In 2006–2010, it reported the following income and (losses) (before net operating loss carryovers or carrybacks).

- a. Assuming the original facts and that MWC elects to not carry back NOLs, what was MWC's 2008 taxable income?
- b. If MWC does not elect to forgo any NOL carrybacks, what is its 2011 taxable income after the NOL deduction?
- c. If MWC always elects to forgo NOL carrybacks, what is its 2011 taxable income after the NOL deduction? What is its 2011 book-tax difference associated with its NOL? Is it favorable or unfavorable? Is it permanent or temporary?

56. (LO2) WCC Inc. has a current year (2011) net operating loss of \$100, 000. It is trying to determine whether it should carry back the loss or whether it should elect to forgo the carryback. How would you advise WCC in each of the following alternative situations (ignore the time value of money in your computations)?

57. (LO2) Assume that in year 1 Hill Corporation reported a net operating loss of \$10, 000 that is carried forward to year 2. In year 1, Hill also reported a net capital loss of \$3, 000 that is carried forward to year 2. In year 3, ignoring any carryovers from other years, Hill reported a loss for tax purposes of \$50, 000. The current year loss includes a \$12, 000 net capital gain. What is Hill's year 2 net operating loss?

58. (LO2) Golf Corp. (GC), a calendar-year accrual-method corporation, held its directors meeting on December 15 of year 1. During the meeting, the board of directors authorized GC to pay a \$75, 000 charitable contribution to the Tiger Woods Foundation, a qualifying charity.

- a. If GC actually pays \$50, 000 of this contribution on January 15 of year 2 and the remaining \$25, 000 on March 15 of year 2, what book-tax difference will it report associated with the contribution in year 1 (assume the 10 percent limitation does not apply)? Is it favorable or unfavorable? Is it permanent or temporary?
- b. Assuming the same facts as in part a, what book-tax difference will GC report in year 2 (assuming the 10 percent limitation does not apply)? Is it favorable or unfavorable?
- c. If GC actually pays \$50, 000 of this contribution on January 15 of year 2 and the remaining \$25, 000 on April 15 of year 2, what book-tax difference will it report associated with the contribution in year 1 (assume the 10 percent limitation does not apply)? Is it favorable or unfavorable? Is it permanent or temporary?

- d. Assuming the same facts as in part c, what book-tax difference will GC report in year 2 (assuming the 10 percent limitation does not apply)? Is it favorable or unfavorable?

59. (LO2) In year 1 (the current year), OCC Corp. made a charitable donation of \$200, 000 to the Phil and Amy Mickelson Foundation (a qualifying charity). For the year, OCC reported taxable income of \$1, 500, 000 before deducting any charitable contributions, before deducting its \$20, 000 dividends received deduction, and before deducting its \$40, 000 NOL carryover from last year.

- a. What amount of the \$200, 000 donation is OCC allowed to deduct for tax purposes in year 1?
- b. In year 2, OCC did not make any charitable contributions. It reported a taxable income of \$300, 000 before any charitable contribution deductions and before a \$15, 000 dividends received deduction. What book-tax difference associated with the charitable contributions will OCC report in year 2? Is the difference favorable or unfavorable? Is it permanent or temporary?
- c. Assume the original facts and those provided in part b. In years 3, 4, and 5, OCC reported taxable losses of \$50, 000. Finally, in year 6 it reported \$1, 000, 000 in taxable income before any charitable contribution deductions. It did not have any dividends received deduction. OCC did not actually make any charitable donations in year 6. What book-tax difference associated with charitable contributions will OCC report in year 6?

60. (LO2) In year 1 (the current year), LAA Inc. made a charitable donation of \$100, 000 to the American Red Cross (a qualifying charity). For the year, LAA reported a taxable income of \$550, 000, which included a \$100, 000 charitable contribution deduction (before limitation), a \$50, 000 dividends received deduction, a \$20, 000 domestic production activity deduction, and a \$10, 000 net operating loss carryover from year 0. What is LAA Inc.'s charitable contribution deduction for year 1?

61. (LO2) Coattail Corporation (CC) manufactures and sells women and children's coats. This year, CC donated 1, 000 coats to a qualified public charity. The charity distributed the coats to needy women and children throughout the region. At the time of the contribution, the fair market value of each coat was \$80. Determine the amount of CC's charitable contribution (the taxable income limitation does not apply) for the coats assuming the following:

- a. CC's adjusted basis in each coat was \$30.
- b. CC's adjusted basis in each coat was \$10.

62. (LO2) Maple Corp. owns several pieces of highly valued paintings that are on display in the corporation's headquarters. This year, it donated one of the paintings valued at \$100, 000 (adjusted basis of \$25, 000) to a local museum for the museum to display. What is the amount of Maple Corp.'s charitable contribution deduction for the painting (assuming income limitations do not apply)? What would be Maple's deduction if the museum sold the painting one month after it received it from Maple?

63. (LO2) Riverbend Inc. received a \$200, 000 dividend from stock it held in Hobble Corporation. Riverbend's taxable income is \$2, 100, 000 before deducting the dividends received deduction (DRD), a \$40, 000 NOL carryover, a \$10, 000 domestic production activities deduction, and a \$100, 000 charitable contribution.

- a. What is Riverbend's deductible DRD assuming it owns 10 percent of Hobble Corporation?
- b. Assuming the facts in part a, what is Riverbend's marginal tax rate on the dividend?
- c. What is Riverbend's DRD assuming it owns 60 percent of Hobble Corporation?
- d. Assuming the facts in part c, what is Riverbend's marginal tax rate on the dividend?
- e. What is Riverbend's DRD assuming it owns 85 percent of Hobble Corporation (and is part of the same affiliated group)?
- f. Assuming the facts in part e, what is Riverbend's marginal tax rate on the dividend?

64. (LO2) Wasatch Corp. (WC) received a \$200, 000 dividend from Tager Corporation (TC). WC owns 15 percent of the TC stock. Compute WC's deductible DRD in each of the following situations:

- a. WC's taxable income (loss) without the dividend income or the DRD is \$10, 000.
- b. WC's taxable income (loss) without the dividend income or the DRD is (\$10, 000).

- c. WC's taxable income (loss) without the dividend income or the DRD is (\$59, 000).
- d. WC's taxable income (loss) without the dividend income or the DRD is (\$61, 000).
- e. WC's taxable income (loss) without the dividend income or the DRD is (\$500, 000).
- f. What is WC's book-tax difference associated with its DRD in part a? Is the difference favorable or unfavorable? Is it permanent or temporary?

65. (LO2) Compute SWK Inc.'s tax liability for each of the following scenarios:

- a. SWK's taxable income is \$60, 000.
- b. SWK's taxable income is \$275, 000.
- c. SWK's taxable income is \$15, 500, 000.
- d. SWK's taxable income for the year is \$50, 000, 000.

66. (LO2) ABC's taxable income for the year is \$200, 000 and CBA's taxable income for the year is \$400, 000. Compute the combined tax liability of the two corporations assuming the following:

- a. Amanda, Jermaine, and O'Neil each own one-third of the stock of ABC and CBA.
- b. Amanda, Jermaine, and O'Neil each own one-third of the stock of ABC, and Amanda and Dustin each own 50 percent of the stock of CBA.
- c. ABC owns 85 percent of CBA's stock on the last day of the year. ABC and CBA file separate (as opposed to consolidated) tax returns.

67. (LO2) ABC's taxable income for the year is \$25, 000 and CBA's taxable income for the year is \$10, 000, 000. Compute the combined tax liability of the two corporations assuming the following:

- a. Amanda, Jermaine, and O'Neil each own one-third of the stock of ABC and CBA.
- b. Amanda, Jermaine, and O'Neil each own one-third of the stock of ABC, and Amanda and Dustin each own 50 percent of the stock of CBA.

68. (LO3) Last year, TBA Corporation, a calendar-year taxpayer, reported a tax liability of \$100, 000. TBA confidently anticipates a current-year tax liability of \$240, 000. What minimum estimated tax payments should TBA make for the first, second, third, and fourth quarters respectively (ignore the annualized income method) assuming the following:

- a. TBA is not considered to be a large corporation for estimated tax purposes.
- b. TBA is considered to be a large corporation for estimated tax purposes.

69. (LO3) Last year, BTA Corporation, a calendar-year taxpayer, reported a net operating loss of \$10, 000 and a \$0 tax liability. BTA confidently anticipates a current-year tax liability of \$240, 000. What minimum estimated tax payments should BTA make for the first, second, third, and fourth quarters respectively (ignore the annualized income method) assuming the following:

- a. BTA is not considered to be a large corporation for estimated tax purposes.

- b. BTA is considered to be a large corporation for estimated tax purposes.

70. (LO3) For the current year, the LNS corporation reported the following taxable income at the end of its first, second, and third quarters. What are LNS's minimum first, second, third, and fourth quarter estimated tax payments determined using the annualized income method?

71. (LO3) Last year, JL Corporation's tax liability was \$900, 000. For the current year, JL Corporation reported the following taxable income at the end of its first, second, and third quarters (see table below). What is JL's minimum required first, second, third, and fourth quarter estimated tax payments (ignore the actual current year tax safe harbor)?

72. (LO3) Last year, Cougar Corp. (CC) reported a net operating loss of \$25, 000. In the current year, CC expected its current year tax liability to be \$440, 000 so it made four equal estimated tax payments of \$110, 000 each. Cougar closed its books at the end of each quarter. The following schedule reports CC's taxable income at the end of each quarter: CC's current year tax liability on \$1, 470, 588 of taxable income is \$480, 000. Does CC owe underpayment penalties on its estimated tax payments? If so, for which quarters does it owe the penalty?

73. (LO2, LO4) For the current year, CCP Inc. received the following interest income: \$12, 000 interest from Irvine City bonds: Bonds issued in 2006 and proceeds used to fund public schools. \$20, 000 interest from Fluor Corporation bonds. \$8, 000 interest from Mission Viejo City: Bonds issued in 2008 and proceeds used to lure new

businesses to the area.

\$6, 000 interest from U. S. Treasury notes.

- a. What amount of this interest income is taxable to CCP?
- b. What amount of interest should CCP report as a preference item when calculating its alternative minimum tax liability?

74. (LO4) On January 2 of year 1, XYZ Corp. acquired a piece of machinery for \$50, 000. The recovery period for the assets is seven years for both regular tax and AMT purposes. XYZ uses the double-declining balance method to compute its tax depreciation on this asset, and it uses a 150 percent declining balance to determine its depreciation for AMT purposes. The following schedule projects the tax and AMT depreciation on the asset until it is fully depreciated:

- a. What AMT adjustment relating to depreciation on the equipment will XYZ make for year 1? Is the adjustment positive (unfavorable) or negative (favorable)?
- b. What AMT adjustment relating to depreciation on the equipment will XYZ make for year 5? Is the adjustment positive or negative?
- c. If XYZ sells the equipment for \$30, 000 at the beginning of year 3, what AMT adjustment will it make in year 3 to reflect the difference in the gain or loss for regular tax and for AMT purposes on the sale (assume no year 3 depreciation)? Is the adjustment positive or negative?

75. (LO4) During the current year, CRS Inc. reported the following tax-related information: \$10, 000 tax-exempt interest from public activity bonds issued

before 2009. \$16, 000 tax-exempt interest from private activity bonds issued before 2009. \$150, 000 death benefit from life insurance policies on officers' lives. \$6, 000 70 percent dividends received deduction.

- \$12, 000 80 percent dividends received deduction.
- \$50, 000 bad debt expense.
- \$20, 000 tax amortization expense relating to organizational expenditures. \$80, 000 gain included in taxable income under the installment method (sale occurred in the previous year). What is CRS's current year ACE adjustment?

76. (LO4) During the current year, ELS Corporation reported the following tax-related information: \$5, 000 tax-exempt interest from public activity bonds issued in 2008. \$45, 000 gain included in taxable income under the installment method. The installment sale occurred two years ago.

- a. What is ELS Corp.'s current year ACE adjustment assuming its cumulative ACE adjustment as of the beginning of the year is a positive \$12, 000?
- b. What is ELS Corp.'s current year ACE adjustment assuming its cumulative ACE adjustment as of the beginning of the year is a positive \$80, 000?

77. (LO4) During the current year, FTP Corporation reported a regular taxable income of \$500, 000. FTP used the following information in its tax-related computations:

\$12, 000 interest from Irvine City bonds: Bonds issued in 2007 and proceeds used to fund public schools. \$20, 000 interest from Fluor Corporation bonds.

\$8, 000 interest from Mission Viejo City bonds: Bonds issued in 2006 and proceeds used to lure new businesses to the area.

\$6, 000 interest from U. S. Treasury notes.

\$30, 000 dividends received from General Electric Corporation (FTP owns less than 1 percent of GE stock).

\$10, 000 dividends received from Hobbles Inc. (FTP owns 25 percent of Hobbles Inc.). \$25, 000 charitable contribution to the Phil and Amy Mickelson Foundation. \$60, 000 AMT depreciation (regular tax depreciation was \$70, 000). \$50, 000 ACE depreciation. \$7, 000 AMT gain on disposition of assets (regular tax gain on the disposition of assets was \$8, 000). \$5, 000 ACE gain on disposition of assets.

- a. What is FTP's ACE adjustment for the current year? Is it positive or negative? b. What is FTP's alternative minimum tax base?
- c. What is FTP's alternative minimum tax liability, if any?

78. (LO4) What is WSS Corporation's AMT base in each of the following alternative scenarios?

- a. WSS's AMTI is \$50, 000.
- b. WSS's AMTI is \$175, 000.
- c. WSS's AMTI is \$300, 000.
- d. WSS's AMTI is \$1, 000, 000.

79. (LO4) Assume CDA corporation must pay the AMT for the current year. It is considering entering into a transaction that will generate \$20, 000 of income for the current year. What is CDA's after-tax benefit of receiving this income in each of the following alternative scenarios?

- a. CDA's AMTI before the transaction is \$50, 000.
- b. CDA's AMTI before the transaction is \$140, 000.
- c. CDA's AMTI before the transaction is \$200, 000.
- d. CDA's AMTI before the transaction is \$1, 000, 000.

80. (LO4) Assume JJ Inc. must pay the AMT for the current year. Near the end of the year, JJ is considering making a charitable contribution of \$20, 000. What is its after-tax cost of the contribution under each of the following alternative scenarios?

- a. JJ's AMTI before the transaction is \$50, 000.
- b. JJ's AMTI before the transaction is \$160, 000.
- c. JJ's AMTI before the transaction is \$200, 000.
- d. JJ's AMTI before the transaction is \$1, 000, 000.

81. (LO4) Compute ACC Inc.'s tentative minimum tax (TMT), alternative minimum tax (AMT), and minimum tax credit (MTC) in each of the following alternative scenarios:

- a. ACC's alternative minimum tax base is \$500, 000 and its regular tax liability is \$80, 000.
- b. ACC's alternative minimum tax base is \$300, 000 and its regular tax liability is \$80, 000.
- c. ACC's alternative minimum tax base is \$1, 000, 000 and its regular tax liability is \$250, 000.

82. (LO4) In year 1, GSL Corp.'s alternative minimum tax base was \$2, 000, 000 and its regular tax liability is \$350, 000.

- a. What is GSL's total tax liability for years 1, 2, 3, and 4 (by year) assuming the following? Year 2: AMT base \$600, 000; Regular tax liability \$100, 000.
Year 3: AMT base \$500, 000; Regular tax liability \$160, 000.
Year 4: AMT base \$1, 000, 000; Regular tax liability \$150, 000.
- b. What, if any, the minimum tax credit does GSL have at the end of year 4?

83. (LO4) In year 1, Lazy corporation reported a \$500, 000 net operating loss for regular tax purposes and a \$450, 000 net operating loss for alternative minimum tax purposes (called an alternative tax net operating loss). In year 2, Lazy reported \$450, 000 of taxable income before deducting its net operating loss carryover from year 1 (it elected to forgo the net operating loss carryback). It also reported \$450, 000 of alternative minimum taxable income before taking the alternative tax net operating loss carryover into account