Chapter Eleven

**The Corporate Income Tax**

**Learning Objective 11.1 Corporate Tax Rates**

Corporate tax rates have eight tax brackets with marginal tax rates from 15 percent to 39 percent. The following table shows the corporate tax rates:

|  |  |  |  |
| --- | --- | --- | --- |
| **Taxable**  **Income Over** | **But Not Over** | **The Tax Is** | **Of the**  **Amount Over** |
| $ 0 | $ 50,000 | 15 % | $ 0 |
| 50,000 | 75,000 | $ 7,500 + 25% | 50,000 |
| 75,000 | 100,000 | 13,750 + 34% | 75,000 |
| 100,000 | 335,000 | 22,250 + 39% | 100,000 |
| 335,000 | 10,000,000 | 113,900 + 34% | 335,000 |
| 10,000,000 | 15,000,000 | 3,400,000 + 35% | 10,000,000 |
| 15,000,000 | 18,333,333 | 5,150,000 + 38% | 15,000,000 |
| 18,333,333 | - | 6,416,667 + 35% | 18,333,333 |

Qualified personal service corporation are taxed at a flat 35 percent tax rate on all taxable income. Qualified personal service corporations are substantially employee-owned and engaged in one of the following activities:

* Health
* Law
* Engineering
* Architecture
* Accounting
* Actuarial science
* Performing arts
* Consulting

###### Learning Objective 11.2 Corporate Capital Gains and Losses

Corporations with net long-term capital gains have two alternative tax treatments. The net long-term capital gain can be included in ordinary income or an alternative tax can be paid. The alternative rate is 35 percent, the same as the maximum regular corporate rate. Net short-term capital gains of a corporation are taxed as ordinary income. Corporations may not deduct capital losses against ordinary income. Capital losses may be carried back three year and forward five years.

### Learning Objective 11.3 Special Deductions and Limitations

Corporations are allowed special deductions. The first is a deduction for dividends received from another corporation, since the dividends would be taxed three times without the provision. The amount of deduction is based on the overall percentage of ownership of the corporation paying the dividend. If the corporation makes an election, expenses of organization may be amortized. The election must be made on the tax return of the corporation for the first taxable year. Examples of qualifying organization expenses include legal and accounting services to initiate the organization, fees paid for corporate filings, and organizational meetings. Corporations are also allowed a deduction for contributions to qualified charitable organizations. The deduction is limited to 10 percent of taxable income, computed before the deduction for charitable deductions. Excess contributions may be carried forward for five years, but are still subject to 10 percent of taxable income for that year.

### Learning Objective 11.4 Schedule M-1

Because tax laws and accounting rules are not the same, a corporation’s taxable income is rarely equal to the net income per the financial statements. Schedule M-1 is a reconciliation of the two income amounts. Examples of differences included depreciation expenses, entertainment expenses and net capital losses deducted for book but not tax purposes.

### Learning Objective 11.5 Filing Requirements and Estimated Tax

The tax return for regular corporations is a Form 1120; for an S Corporation, the tax return is filed on a Form 1120S. Corporate tax returns are due on the fifteenth day of the third month following the tax year-end. A Form 7004 can be filed for an automatic six-month extension to file, but not an extension to pay. Corporations make estimated tax payments in a manner similar to those made by self-employed individual taxpayers.

**Learning Objective 11.6 S Corporations**

An S Corporation does not generally pay tax, but rather each shareholder reports his or her share of corporate income. The S Corporation election is designed to relieve small corporations of certain corporate tax disadvantages, such as double taxation of income. To elect S Corporation status, the following conditions must be met:

1. The corporation must be a domestic corporation
2. The corporation must have 100 or fewer shareholders, who are all individuals, estates, certain trusts, certain financial institutions or certain exempt organizations
3. The corporation must have only one class of stock
4. All shareholders must be U.S. citizens or resident aliens

The corporation remains an S Corporation until changes are made, such as additional stockholders increase the total stockholders to more than 100 or various classes of stock are offered. Upon consent of shareholders owning a majority of the voting stock, an S Corporation may revoke the status voluntarily.

The shareholders of S Corporations receive a Schedule K-1 from Form 1120S for their allocation of ordinary income or loss. Losses from an S Corporation pass through to the shareholders; however the losses are limited to the adjusted basis in the corporation’s stock and any loans to the corporation from the shareholder. Pass-through items from an S Corporation to shareholders included capital gains and losses, Section 1231 gains and losses, dividend income, charitable contributions, tax-exempt interest and most credits. S Corporations may have to pay taxes on certain items such as passive investment income.

**Learning Objective 11.7 Corporate Formation**

Since many taxpayers exchange high-value, low-basis property in exchange for stock in a newly formed corporation, tax laws were established to defer the gain. The requirements necessary for the deferral include:

1. The taxpayer must transfer property or money to the corporation
2. The transfer must be solely in exchange for stock of the corporation, and
3. The shareholder(s) qualifying for nonrecognition must own at least 80 percent of the corporation’s stock after the transfer.

If all requirements are met, losses and gains are not recognized on the formation of the corporation. Typically, when a corporation takes over shareholder liabilities, the assumption is not considered to be boot. However, if the corporation takes over the liability for no business purpose or to avoid paying taxes, the recognition of any realized gain is required. After the transfer, the shareholder’s basis in stock is determined as follows:

Basis of the property transferred $XXX

Less: boot received (XXX)

Plus: gain recognized XXX

Less: liabilities transferred (XXX)

Basis in the stock $XXX

Learning Objective 11.8 Corporate Accumulations

In some cases, individuals have established corporations to avoid paying individual income taxes. Congress has enacted two special taxes to discourage these practices. The first tax is the accumulated earnings tax. This tax is designed to prevent shareholders from retaining earnings in a corporation rather than paying taxes on the earnings. The tax is imposed at 15 percent for any unreasonable accumulation of earnings. For most corporations, the first $250,000 is exempt from tax. The second tax is the personal holding company tax. Personal holding companies are corporations with few shareholders and income primarily from investments.

###### Learning Objective 11.9 The Corporate Alternative Minimum Tax

The corporate alternative minimum tax is calculated like the individual alternative minimum tax. The tax is imposed at a 20 percent rate on the alternative minimum tax base (regular taxable income plus corporate tax preferences less exemptions). Common corporate tax adjustments and preferences include accelerated depreciation on real estate, accelerated depreciation on personal property, tax-exempt bond interest, percentage depletion in excess of the property’s adjusted basis and seventy-five percent of the difference between adjusted current earnings and alternative minimum taxable income determined before this adjustment and the alternative tax net operating loss deduction.