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% - 39%

|  |  |  |  |
| --- | --- | --- | --- |
| **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 (PSC) are taxed at a flat 35% tax rate on all taxable income.

Qualified PSCs 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.

* Can be included in ordinary income or an alternative tax can be paid.
  + Alternative rate is 35%, 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. And may be carried back 3 year and forward 5.

### Learning Objective 11.3 Special Deductions and Limitations

#### Corporations are allowed special deductions.

#### A deduction for dividends received from another corporation – amount is based upon percentage of ownership as follows:

|  |  |
| --- | --- |
| *Percent Ownership* | *Dividends Received Deduction Percentage* |
| Less than 20% | 70% |
| 20% or more, but less than 80% | 80% |
| 80% or more | 100% |

#### The expenses of organization may be amortized over 180 months, with no upper limit.

#### Corp can deduct up to $5000 in the year they begin business (with a phase-out when expenses exceed $50,000)

#### The election must be made on the tax return 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 can deduct contributions to qualified charitable organizations.

#### Deduction is limited to 10% of taxable income, computed before the deduction for charitable deductions

#### Excess contributions may be carried forward for 5 years, but are still subject to 10% 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, charitable contributions and net capital losses deducted for book but not tax purposes

### Learning Objective 11.5 Filing Requirements and Estimated Tax

* Form 1120 is filed for a C corporation
* Form 1120S is filed for an S Corporation
* Corporate tax returns are due on the 15th day of the third month following tax year-end
  + A Form 7004 can be filed for an automatic 6-month extension to file, but is *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

* 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 either 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

* S Corporations may have to pay taxes on certain items such as passive investment income.

The shareholders of S Corporations receive a Schedule K-1 from Form 1120S

* It allocates ordinary income or loss
* Losses from an S Corporation pass through to the shareholders
  + 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.

**Learning Objective 11.7 Corporate Formation**

The requirements necessary for the deferral of gains when contributing property to an S corp 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% of the corporation’s stock after the transfe.

If all requirements are met, losses and gains are not recognized on formation of the corporation.

* Typically, when a corporation takes over shareholder liabilities, the amount is not considered to be boot.
* Recognition of realized gain is required if:
  + Corporation takes over the liability for no business purpose or to avoid paying taxes, the.

After the transfer, the shareholder’s basis in stock is determined as follows:

Basis of the property transferred

Less: boot received

Plus: gain recognized

Less: liabilities transferred

Basis in the stock

Corporation’s basis in property received from a shareholder is the same as the basis of property to shareholder, increased by any gain recognized by shareholder on the transfer

Learning Objective 11.8 Corporate Accumulations

Congress has enacted two special taxes to discourage setting up corporations to avoid paying individual income tax:

* Accumulated earnings tax (AET) prevents shareholders from retaining earnings in a corporation rather than paying taxes on the earnings
  + 15% for any unreasonable accumulation of earnings.
  + For most corporations, the first $250,000 is exempt from tax
  + Service corporations will not be taxed on their first $150,000 of AET
* The personal holding company ta is applied to corporations with few shareholders and income primarily from investments; they are subject to 20% tax on their undistributed earnings.

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

The corporate alternative minimum tax is calculated like the individual alternative minimum tax.

* 20% on the alternative minimum tax base
  + Equals = Regular taxable income + corporate tax preferences – exemptions
* Common corporate tax adjustments and preferences include
  + Accelerated depreciation on real estate and personal property
  + Tax-exempt bond interest
  + Percentage depletion in excess of the property’s adjusted basis and
  + 75% of the difference between adjusted current earnings and AETI determined before this adjustment and the alternative tax net operating loss deduction