*SWFT 2018 Corporations, Partnerships, Estates and Trusts*

Chapter 3: Corporations: Special Situations

End-of-Chapter Question, Exercise, and Problem Correlations

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Corporations, Partnerships, Estates and Trusts 40e (2017)** | **Corporations, Partnerships, Estates and Trusts 41e (2018)** | **Corporations, Partnerships, Estates and Trusts 41e (2018) Learning Objectives** | **Exact**  **Same** | **Revised** | **Brand New** |
| **Discussion Questions (DQ)** | |  |  |  |  |
| DQ1 | DQ1 | LO1 | **x** |  |  |
| DQ2 | DQ2 | LO1,2,3,4,5 | **x** |  |  |
| DQ3 | deleted | N/A |  |  |  |
| DQ4 | DQ3 | LO3 | **x** |  |  |
| DQ5 | DQ4 | LO3,11 | **x** |  |  |
| DQ6 | DQ5 | LO3,11 | **x** |  |  |
| DQ7 | DQ6 | LO3,5 | **x** |  |  |
| DQ8 | deleted | N/A |  |  |  |
| DQ9 | DQ7 | LO5 | **x** |  |  |
| DQ10 | DQ8 | LO6 | **x** |  |  |
| DQ11 | DQ9 | LO6 | **x** |  |  |
| DQ12 | DQ10 | LO6,7 | **x** |  |  |
|  | DQ11 | LO7 |  |  | **x** |
|  | DQ12 | LO7 |  |  | **x** |
|  | DQ13 | LO7 |  |  | **x** |
|  | DQ14 | LO7 |  |  | **x** |
|  | DQ15 | LO7 |  |  | **x** |
| DQ13 | DQ16 | LO7,8 | **x** |  |  |
| DQ14 | DQ17 | LO6,7,8 | **x** |  |  |
| DQ15 | DQ18 | LO8 | **x** |  |  |
| DQ16 | DQ19 | LO8 | **x** |  |  |
| DQ18 | DQ20 | LO9 |  | **x** |  |
| DQ19 | DQ21 | LO10 | **x** |  |  |
| DQ20 | DQ22 | LO11 | **x** |  |  |
| DQ21 | DQ23 | LO11 | **x** |  |  |
| **Computational Exercises (EX)** | |  |  |  |  |
| EX22 | EX24 | LO2 | **x** |  |  |
| EX23 | EX25 | LO2 | **x** |  |  |
| EX24 | EX26 | LO3 | **x** |  |  |
| EX25 | EX27 | LO3 | **x** |  |  |
| EX26 | deleted | N/A |  |  |  |
| EX27 | EX28 | LO4 | **x** |  |  |
|  | EX29 | LO7 |  |  | **x** |

**EOC 3-1**

South-Western Federal Taxation 2018 Edition Series End-of-Chapter Question, Exercise, and Problem Correlations:

*Corporations, Partnerships, Estates and Trusts (Volume 2)*

|  |  |  |  |  |  |
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| **Corporations, Partnerships, Estates and Trusts 40e (2017)** | **Corporations, Partnerships, Estates and Trusts 41e (2018)** | **Corporations, Partnerships, Estates and Trusts 41e (2018) Learning Objectives** | **Exact**  **Same** | **Revised** | **Brand New** |
|  | EX30 | LO7 |  |  | **x** |
|  | EX31 | LO7 |  |  | **x** |
|  | EX32 | LO7 |  |  | **x** |
| EX28 | EX33 | LO7 |  | **x** |  |
| EX29 | EX34 | LO8 |  | **x** |  |
| EX30 | EX35 | LO10 |  | **x** |  |
| EX31 | EX36 | LO10 |  | **x** |  |
| **Problems (PR)** |  |  |  |  |  |
| PR32 | PR37 | LO1 |  | **x** |  |
| PR33 | PR38 | LO2 |  | **x** |  |
| PR34 | PR39 | LO3 | **x** |  |  |
| PR35 | deleted | N/A |  |  |  |
| PR36 | PR40 | LO3 | **x** |  |  |
| PR37 | deleted | N/A |  |  |  |
| PR38 | deleted | N/A |  |  |  |
| PR39 | deleted | N/A |  |  |  |
| PR40 | PR41 | LO2,3,4 |  | **x** |  |
| PR41 | PR42 | LO2,3,4 | **x** |  |  |
| PR42 | PR43 | LO5 |  | **x** |  |
| PR43 | PR44 | LO2,3,4,5 |  | **x** |  |
| PR44 | deleted | N/A |  |  |  |
| PR45 | PR45 | LO6 |  | **x** |  |
|  | PR46 | LO7,8 |  |  | **x** |
|  | PR47 | LO7,8 |  |  | **x** |
|  | PR48 | LO7,8 |  |  | **x** |
|  | PR49 | LO7,8 |  |  | **x** |
|  | PR50 | LO7,8 |  |  | **x** |
|  | PR51 | LO7,8 |  |  | **x** |
|  | PR52 | LO7,8 |  |  | **x** |
|  | PR53 | LO7,8 |  |  | **x** |
|  | PR54 | LO7,8 |  |  | **x** |
| PR46 | PR55 | LO6,7 |  | **x** |  |
| PR47 | PR56 | LO6,7 |  | **x** |  |
| PR48 | PR57 | LO6,7 |  | **x** |  |
| PR49 | PR58 | LO8 |  | **x** |  |
| PR50 | PR59 | LO8 | **x** |  |  |
| PR51 | PR60 | LO6,7 | **x** |  |  |
| PR52 | PR61 | LO8 | **x** |  |  |

**EOC 3-2**

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South-Western Federal Taxation 2018 Edition Series End-of-Chapter Question, Exercise, and Problem Correlations: *Corporations, Partnerships, Estates and Trusts (Volume 2)*

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| --- | --- | --- | --- | --- | --- |
| **Corporations, Partnerships, Estates and Trusts 40e (2017)** | **Corporations, Partnerships, Estates and Trusts 41e (2018)** | **Corporations, Partnerships, Estates and Trusts 41e (2018) Learning Objectives** | **Exact**  **Same** | **Revised** | **Brand New** |
| PR53 | PR62 | LO10 | **x** |  |  |
| PR54 | PR63 | LO10 |  | **x** |  |
| **Cumulative (Tax Return) Problems (CP)** | |  |  |  |  |
| N/A |  |  |  |  |  |
| **Research Problems (RP)** | |  |  |  |  |
| RP1 | RP1 |  | **x** |  |  |
| RP2 | RP2 |  |  | **x** |  |
| RP3 | RP3 |  | **x** |  |  |
| RP4 | RP4 |  | **x** |  |  |
| RP5 | RP5 |  | **x** |  |  |
| **Roger CPA Review Questions (RCPA)** | |  |  |  |  |
| RCPA1 | RCPA1 |  |  | **x** |  |
| RCPA2 | RCPA2 |  | **x** |  |  |
| RCPA3 | RCPA3 |  | **x** |  |  |
| RCPA4 | RCPA4 |  | **x** |  |  |
| RCPA5 | RCPA5 |  | **x** |  |  |

**EOC 3-3**

**CHAPTER 3**

**CORPORATIONS: SPECIAL SITUATIONS**

**SOLUTIONS TO PROBLEM MATERIALS**

# DISCUSSION QUESTIONS

1. (LO 1) This deduction is available to a variety of taxpayers including individuals, corporations, partnerships, S corporations, cooperatives, estates, and trusts. It is apt to be found more frequently among corporations (both C and S types) rather than individuals. The reason is that manufacturing activities require capital, which is more easily raised through the corporate form.
2. (LO 1, 2, 3, 4, 5)
   1. DPAD cannot exceed 50% of W–2 wages.
   2. DPAD is a percentage (currently 9%) of the lesser of QPAI or TI, but not to exceed 50% of W–2 wages.
   3. DPAD is limited to 9% of the lesser of taxable income or QPAI.
   4. DPGR, when reduced by CGS and direct and indirect expenses, becomes QPAI.
   5. DPAD is allowed for purposes of the AMT.
3. (LO 3)
   1. Yes. An overall *de minimis* safe harbor test is applicable when small amounts of non-DPGR are present. A taxpayer with less than 5% of total gross receipts from non-DPGR may treat all gross receipts as DPGR and avoid the need to allocate.
   2. Yes, when the benefits to be derived from § 199 are so minimal that the cost of compliance is not worth the tax savings that will result.
   3. Where the cost of compliance is not worth the tax savings, a reverse *de minimis* safe harbor exists. Under this provision, a taxpayer can treat all of its receipts as non-DPGR if less than 5% of the total is DPGR.
4. (LO 3, 11)
   1. When the sale of a product entails the rendition of a service regarding that product, the service element is embedded in the selling price.
   2. Examples of embedded services include product warranties, maintenance arrangements, training in product use, and customer call-in assistance.
   3. When the embedded service is not separately priced or when its cost meets a 5% *de minimis* test, it can be included in DPGR.

**3-1**

1. (LO 3, 11)
   1. DPGR refers to domestic production. Foreign production is allowed, however, but only if the domestic portion remains “significant,” as defined in part b. below.
   2. Significant means substantial. A safe harbor exists in meeting this definition when the U.S. costs account for 20% or more of the total CGS of the property.
   3. The problem will arise quite frequently because the components of many U.S. goods are produced by foreign affiliates.

1. (LO 3, 5)
   1. Section 199(c)(4)(B)(i) specifically excludes from DPGR any receipts from the sale of food and beverages by a taxpayer at retail. Frozen prepared foods sold to grocery stores, however, will qualify.
   2. No, it would not matter. Reg. § 1.199–3(o) states that take-out and delivery services will be treated the same as prepared meals served on the premises.
2. (LO 5) The DPAD is allowed for purposes of the alternative minimum tax (AMT), except that the deduction is equal to 9% of the smaller of (1) QPAI or (2) alternative minimum taxable income (without considering the DPAD) for the tax year. In the case of an individual, modified AGI (ignoring the DPAD) is substituted for AMTI.
3. (LO 6) Technically, this statement is incorrect. The AMT is a separate tax system with a quasi-flat tax rate which is applied each year to a corporation’s economic income. If the tentative minimum tax is greater than the regular corporate income tax under § 11, then the corporation must pay the regular tax plus this excess, the alternative minimum tax (AMT).
4. (LO 6) A corporation initially qualifies as a small corporation in its first tax year in existence regardless of its gross receipts. After the initial year, the exemption applies if two requirements are met.
   * The corporation must have been treated as a small corporation exempt from the AMT for all prior years beginning after 1997, and
   * Average annual gross receipts for the three-year tax period (or portion thereof during which the corporation was in existence) ending before its tax year beginning in 2017 did not exceed $7.5 million ($5 million if the corporation has only one prior year).

Thus, the $5 million rule only applies in testing for the second year of a new corporation’s life. So if a corporation had gross receipts of $5 million or less its first year, the second year is exempted.

1. (LO 6, 7) Tax preference items are only positive. Adjustments are often timing differences and may be positive or negative.
2. (LO 7) A personal holding company (PHC) that deducts circulation expenditures currently for regular tax purposes must capitalize them and amortize them over three years for AMT purposes. So, by capitalizing and amortizing them over three years for regular tax purposes, the PHC avoids the AMT positive adjustment.

1. (LO 7) Cost depletion is not available once the taxpayer’s mineral basis drops to zero. But percentage depletion is based on gross income from the mineral property and not the company’s investment in the property. Since the percentage depletion deduction can exceed the property basis, any percentage depletion in excess of the property basis is a tax preference item.

1. (LO 7) The AMT IDC preference is computed using a two-step process, as follows:

IDC expensed during the year

Minus: AMT IDCs (the deduction if IDC were capitalized and amortized over 120 months

once production begins)

Equals: Excess IDCs

Excess IDCs

Minus: 65% of net oil and gas or geothermal income (computed using AMT income and

deductions, including AMT IDCs)

Equals: AMT Preference

1. (LO 7) Interest received from a state or local bond that is a qualified private activity bond is excluded from corporate taxable income. Examples of these bonds include those issued by a municipality to fund construction costs of a manufacturing facility (to encourage a business to locate in the municipality) or bonds issued by a city to provide construction financing for a professional sports facility. In both of these cases, a government entity is raising funds to support a *private activity*. Any interest on such a bond is treated as a preference item and added back to the corporate taxable income to arrive at AMTI. Any disallowed related expenses may be deductible from AMTI.

1. (LO 7) Depreciation differences for AMT purposes and regular corporate tax purposes may cause differences in the adjusted basis of assets for AMT and regular tax purposes. The adjusted basis of assets is determined by the amount of deductions allowed for regular tax and AMT purposes. Thus, if a company sells an asset before it is completely depreciated, a different gain or loss may be generated for regular tax than for AMT. The adjustment can be positive or negative.

1. (LO 7, 8)
   1. I. (Add)
   2. N. (No impact)
   3. N. (No impact)
   4. N. (No impact)
   5. I. (Add)
   6. I. [Add (net of cash surrender value previously accounted for)]
   7. I. (Add)
2. (LO 6, 7, 8)
   1. E. Both positive and negative.
   2. E. Both positive and negative.
   3. D.
   4. E. Plus or minus adjustment.
   5. D.
   6. E. Plus or minus adjustment.
   7. I. A tax preference item.
   8. N.
   9. I. A tax preference item.
3. (LO 8)

TAX FILE MEMORANDUM

February 9, 2018

SUBJECT: Janice Boyer

RE: ACE versus Current E & P

I told Ms. Boyer that ACE should not be confused with current E & P. Many items are treated in the same manner, but certain items that are deductible in computing E & P (but are not deductible in calculating taxable income) generally are not deductible in computing ACE (e.g., Federal income taxes). The impact of various transactions on ACE and E & P vary.

The starting point for computing ACE is AMTI, which is defined as regular taxable income after AMT adjustments (other than the NOL and ACE adjustments) and after tax preferences. See § 56(g). The resulting figure is adjusted for a number of items in order to determine ACE (e.g., life insurance proceeds).

1. (LO 8)
   1. Add.
   2. Add.
   3. No effect.
   4. Add.
   5. No effect.
   6. Add.
   7. No effect.
   8. Subtract.
2. (LO 9) Corporate earnings are subject to double taxation—once at the corporate level and then at the shareholder level (when earnings are distributed as a dividend). When dividends were taxed as ordinary income, avoiding corporate distributions often was desirable. In closely held settings where a few high-bracket shareholders control corporate policy, the following approach would be taken.

* 1. Accumulate earnings within the corporation. Distribute dividends, if at all, only when the shareholders are in a favorable tax position (e.g., are in low brackets or have offsetting losses).

* 1. The accumulations will cause the stock to appreciate in value.

* 1. The shareholders ultimately can recognize this appreciation in value at preferential capital gain rates by selling the stock. Or, if the stock is transferred by death, no gain is ever recognized due to the step-up in basis under § 1014 (see Chapter 19).

1. (LO 10)
   1. –. A decrease in taxable income.
   2. NE. Only a taxable stock dividend would result in a reduction in ATI.
   3. NE. Only excess charitable contributions are subtracted.
   4. +.
   5. +.
2. (LO 11) If the production process includes offshore activities, recall that § 199 requires that a “significant part” be performed in the United States. According to the IRS, *significant* means “substantial,” and this condition can be satisfied by meeting a 20% safe-harbor rule (see Examples 9 and 10 in this chapter). In cases where compliance with this safe-harbor rule is questionable, a ready solution would shift some of the offshore production to the United States.
3. (LO 11) To avoid the W–2 wage limitation imposed on the DPAD, the following observations could be placed on PowerPoint slides.
   * For sole proprietors, the self-employment tax does not qualify. In some cases, family members may need to be placed on the payroll to meet the W–2 wage limitation.
   * Wages paid and not reported cannot be counted.
   * Amounts paid to independent contractors do not qualify.
   * Guaranteed payments made to a partner do not qualify.
   * Taxpayers that have both qualifying and nonqualifying sales must keep careful records to allocate their W–2 wages.
   * A taxpayer’s payments to employees for domestic services in a private home are not included in W–2 wages for purpose of the DPAD.
   * An individual filing as part of a joint return may take into account wages paid to employees of his or her spouse, provided the wages are paid in a trade or business (and other requirements are met). This advantage is not true if a taxpayer and spouse file separate returns.

# COMPUTATIONAL EXERCISES

1. (LO 2) The DPAD is equal to the lesser of 9% of qualified production activities income or 9% of taxable income or alternative minimum taxable income. The DPAD is further limited by 50% of the W–2 wages paid by the taxpayer that are allocable to domestic production gross receipts (DPGR), including the sum of the aggregate amount of wages and elective deferrals, required to be included on the W–2 wage statement for the employees during the employer’s taxable year.

Based on this information, Red Oak’s QPAI is $130,000 and its taxable income is $95,000 ($130,000 – $35,000). Red Oak’s DPAD becomes $8,550 [9% of the lesser of $130,000 (QPAI) or $95,000 (TI)].

1. (LO 2) The DPAD is equal to the lesser of 9% of qualified production activities income or 9% of taxable income or alternative minimum taxable income. The DPAD is further limited by 50% of the W–2 wages paid by the taxpayer that are allocable to domestic production gross receipts (DPGR), including the sum of the aggregate amount of wages and elective deferrals, required to be included on the W–2 wage statement for the employees during the employer’s taxable year.

Although Saluda Hills’ DPAD normally would be $84,600 [9% of the lesser of $940,000 (QPAI) or $980,000 (taxable income)], it is limited to $82,500 [50% of $165,000 (W–2 wages)].

1. (LO 3) In many cases, a taxpayer must determine the portion of its total gross receipts that is DPGR. To determine DPGR, an apportionment will be necessary. The IRS indicates that a taxpayer must use a reasonable method that accurately identifies DPGR and non-DPGR based on all of the information available. If a taxpayer uses a specific identification method (e.g., specifically identifies where the product was MPGE) for any other purpose, the same method must be used to determine DPGR.

An overall de minimis safe harbor test is applicable when small amounts of non-DPGR are present. A taxpayer with less than 5% of total gross receipts from non-DPGR may treat all gross receipts as DPGR and is not required to allocate. However the safe harbor test is not met in this example. $1,100,000/($3,800,000 + $1,100,000) = 22.4% which is not less than 5%.

Therefore, only the gross receipts derived from the United States qualify ($3,800,000).

1. (LO 3) One of the components of DPGR is the lease, rental, license, sale, exchange, or other disposition of qualified production property. Qualified production property (QPP) includes tangible personal property (TPP), computer software, and sound recordings. To qualify as DPGR, QPP must be manufactured, produced, grown, or extracted (MPGE) in whole or in significant part in the United States. Included in this MPGE definition is the making of QPP out of salvage, scrap, or junk materials or by the use of new or raw materials. “Making” can involve processing, manipulating, refining, or changing the form of an article or combining or assembling two or more articles.

The “in whole or in significant part” requirement is satisfied if the employer’s MPGE activity is substantial in nature. The substantial in nature test is a facts and circumstances test. There is a safe harbor if an employer incurs conversion costs (direct labor and related factory burden) related to MPGE of the property in the United States and the costs account for 20% or more of the property’s cost of goods sold.

In this example, the garden tool will be treated as manufactured by SafeCo “in significant part” because SafeCo’s labor costs are substantial—they are more than 20% of the taxpayer’s total cost for the garden tool [$15/($20 + $15) = 42.86%]. As a result, SafeCo’s DPGR is $65, and the full $27 in profit ($65 – $20 – $15 – $3) is QPAI.

1. (LO 4) The adjustments that are necessary to arrive at qualified production activities income (QPAI) include the following.
   1. Cost of goods sold (CGS)
   2. Direct costs
   3. Allocable indirect costs

CGS is equal to beginning inventory plus purchases and production costs and less ending inventory. The taxpayer should use the amount of CGS allocable to DPGR that can be identified using its books and records.

The second category of expenses (direct costs) includes selling and marketing expenses. The third category (allocable indirect costs) is further removed and includes, for example, general and administrative expenses attributable to the selling and marketing expenses.

The second and third categories of expenses (i.e., direct allocable and indirect allocable) may be allocated by one of three methods.

* 1. The § 861 Regulation method may be used by all taxpayers but must be used by those taxpayers with average annual gross receipts of more than $100 million.
  2. For employers with average annual gross receipts of $100 million or less or total assets at the end of the taxable year of $10 million or less, a simplified deduction method based on relative gross receipts is available.
  3. For taxpayers that have average gross receipts of $5 million or less or are eligible to use the cash method, a small business simplified overall method is available.
     1. Under the small business simplified overall method, CGS and deductions are apportioned to DPGR in the same proportion DPGR bears to total gross receipts. Thus, Eclipse’s QPAI is computed as follows.

DPGR $2,160,000

Less allowable CGS (600,000)1

Less allocable expenses (288,000)2

QPAI $1,272,000

1

CGS allocation: [($2,160,000/$3,600,000) = 60% × $1,000,000 = $600,000]

2 Expenses allocation: [($2,160,000/$3,600,000) = 60% × $480,000 = $288,000]

* + 1. Presuming that the taxable income and W–2 wage limitations do not intervene, Eclipse’s DPAD is $114,480 (9% × $1,272,000).

1. (LO 7)

# Year Regular Tax Deduction AMT Amortization AMT Adjustments

1. $30,000$10,000$20,000
2. 10,000 (10,000)
3. 10,000 (10,000)

Totals $30,000$30,000$ –0–

30. (LO 7)

# Year Regular Tax income AMT income AMT Adjustments

1. $ –0–$720,000\*$720,000
2. 1,600,000880,000 (720,000)

\*$1,600,000 × 45%

1. (LO 7) Red, Inc., has a *negative* AMT adjustment of $2,740 (the difference between the regular tax gain of $81,662 and the alternative minimum tax gain of $78,922). As the AMT gain is less than the regular tax gain, the AMT adjustment *reduces* regular taxable income in computing AMTI.

1. (LO 7) Haiyan’s AMT exemption is $22,500, computed as follows.

AMTI $220,000

Phase-out amount (150,000)

Excess $ 70,000

Phase-out percentage × 25%

Phase-out amount $ 17,500

Exemption amount $ 40,000

Less: Phase-out amount ( 17,500) Available exemption $ 22,500

1. (LO 7)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Year** | **Tax Deduction** – **AMT Deduction** =  **AMT Adjustment** | | | **Increases/Decreases** |
| 2017 | $1,667 | $1,250 | $417 | Increases |
| 2018 | $2,222 | $1,875 | $347 | Increases |
| 2019 | $740 | $1,250 | ($510) | Decreases |
| 2020 | $371 | $625 | ($254) | Decreases |
| Totals | $5,000 | $5,000 | $0 |  |

For property placed into service after 1998, an AMT adjustment applies only to MACRS 3-, 5-, 7-, and 10-year property that is depreciated using the 200% declining-balance method. The adjustment is the difference between the depreciation claimed for regular tax purposes and the depreciation using the 150% declining-balance method over the property’s shorter regular MACRS recovery period.

1. (LO 8) The ACE adjustment is tax-based and can be either a positive or a negative amount. AMTI is increased by 75% of the excess of ACE over unadjusted AMTI. Or AMTI is reduced by 75% of the excess of unadjusted AMTI over ACE. This negative adjustment is limited to the aggregate of the positive adjustments under ACE for prior years reduced by the previously claimed negative adjustments. Thus, the ordering of the timing differences is crucial because any unused negative adjustment is lost forever. Unadjusted AMTI is AMTI without the ACE adjustment or the AMT NOL (the IRS refers to this amount as “pre-adjustment AMTI”).

In 2017, because ACE exceeds unadjusted AMTI by $400,000, $300,000 [75% × ($800,000 – $1,200,000) is included as a positive adjustment to AMTI. No adjustment is necessary for 2018. Unadjusted AMTI exceeds ACE by $600,000 in 2019, so there is a potential negative adjustment to AMTI of $450,000 [75% × ($1,500,000 – $900,000)]. Because the total increases to AMTI for prior years equal $300,000 (and there are no negative adjustments), only $300,000 of the $450,000 potential negative adjustment will reduce AMTI for 2019. Further, $150,000 of the negative amount is lost forever ($450,000 – $300,000).

1. (LO 10) The § 531 tax of 20% is imposed on accumulated taxable income (ATI), determined as follows.

ATI = Taxable income +/– Adjustments – Dividends paid – Accumulated earnings credit

The accumulated earnings credit is the greater of (1) the minimum credit of $250,000 ($150,000 for personal service corporations) or (2) the current E & P for the year needed to meet the reasonable needs of the business. In determining the minimum credit or the current E & P required to meet the reasonable needs of the business, the balance of past (i.e., accumulated) E & P must be considered. This balance, once it reaches $250,000, also eliminates the use of the minimum credit.

In most cases, ATI and vulnerability to the § 531 penalty tax are avoided by resorting to the accumulated earnings credit. Hence, it is important to recognize what constitutes the reasonable needs of the business.

Vtech Corporation’s accumulated earnings credit is $700,000: the greater of (1) the minimum tax credit of $250,000 or (2) $700,000, the portion of 2018 current E & P needed to meet the reasonable needs of the business [$3,600,000 (reasonable needs) – $2,900,0000 (accumulated E & P)]. Since Vtech Corporation’s current E & P is the same as taxable income as adjusted, its ATI is $145,000 [$845,000 (taxable income as adjusted) – $700,000 (accumulated earnings credit)].

36. (LO 10) If a corporation is a PHC, a penalty tax of 20% is imposed on undistributed personal holding company income (PHCI). Undistributed PHCI is taxable income plus or minus various adjustments and less the dividends paid deduction. The adjustments are similar to those made in arriving at accumulated taxable income (ATI) for purposes of the § 531 tax, and largely reflect the corporation’s financial capacity to pay dividends. Thus, the dividends received and NOL deductions are added back, and the corporate income tax, excess charitable contributions (i.e., in excess of the 10% limitation), and long-term capital gain (net of tax) are subtracted.

Taxable income $ 345,000

Less: Federal income tax (102,000 )

Add: Dividends-received deduction 30,000

Less: Long-term capital gains (net of taxes) (15,000 ) Less: Current-year dividends paid (200,000 )

Undistributed personal holding company income $ 58,000

Personal holding company tax rate × 20%

Personal holding company tax $ 11,600

# PROBLEMS

1. (LO 1) Assuming the marginal corporate rate is 35% in 2017 and in 2018, in both years the maximum DPAD savings is $346,500 ($11,000,000 × 9% × 35%).
2. (LO 2)
   1. $54,000. The taxable income limitation of $54,000 (9% × $600,000) is less than the QPAI computation of $72,000 (9% × $800,000) and is under the W–2 limitation of $60,000 (50% × $120,000).
   2. $10,000. The W–2 limitation of $10,000 (50% × $20,000) is less than the QPAI computation of $36,000 (9% × $400,000).
   3. $72,000. After the NOL carryover of $100,000, taxable income becomes $800,000 ($900,000 – $100,000). Now, the taxable income limitation of $72,000 (9% × $800,000) is less than the QPAI computation of $81,000 (9% × $900,000) and is under the W–2 limitation of $150,000 (50% × $300,000).
   4. $63,000. The QPAI computation of $63,000 (9% × $700,000) is less than the taxable income limitation of $81,000 (9% × $900,000) and is under the W–2 limitation of $100,000 (50% × $200,000).
   5. $30,000. The QPAI computation of $81,000 (9% × $900,000) is the same as the taxable income limitation of $81,000 (9% × $900,000) but is not under the W–2 limitation of $30,000 (50% × $60,000). For purposes of the W–2 limitation, the wages considered do have to relate to the manufacturing activities in 2017.
3. (LO 3)
   1. Tern’s DPGR is $8,200,000. The $1,000,000 derived from the Nicaragua facility cannot be included under the *de minimis* rule, as the amount exceeds 5%—$1,000,000/$9,200,000 = 10.87%.
   2. Tern’s DPGR now becomes $8,600,000. The $400,000 from Nicaragua is included under the *de minimis* rule—$400,000/$8,600,000 = 4.65%, which is less than 5%.

1. (LO 3)
   1. Although the basic warranty is an embedded service, it is not separately priced or bargained for; the warranty is included as part of the cost of the product. Therefore, the full $3,000 is

DPGR.

* 1. Because the warranty is separately priced, the *de minimis* rule is not available. DPGR still is $3,000.
  2. Because the warranty is separately priced, it does not constitute DPGR. DPGR still is $3,000.
  3. If the price of the product were raised to $3,300 and every item sold was under a 10-year warranty, the full sales price becomes DPGR. Hope’s extended warranties should not be separately priced or bargained for, so as to maximize its DPGR.

1. (LO 2, 3, 4)
   1. $2,600,000. DPGR cannot include gross receipts from the resale of imported goods.
   2. To determine selling, marketing, and administrative expenses allocable to DPGR, use the fraction based on DPGR/total gross receipts. Therefore, ($2,600,000/$4,200,000) × $1,000,000 = $619,048. QPAI is:

DPGR $2,600,000

CGS (1,100,000)

Other expenses (619,048) QPAI $ 880,952

* 1. DPAD is $79,286 (9% × $880,952).

1. (LO 2, 3, 4)
   1. The relative gross receipts method must be used to allocate *both* CGS and other expenses between DPGR and non-DPGR (receipts from the sale of imported goods).

DPGR $2,600,000

Less allocated CGS:

($2,600,000/$4,200,000) × $1,950,000 (1,207,143)

Less allocated other expenses:

($2,600,000/$4,200,000) × $1,000,000 (619,048)

QPAI $ 773,809

* 1. DPAD is $69,643 (9% × $773,809).

1. (LO 5)
   1. $2,000,000. The snack shop receipts do not meet the *de minimis* rule ($110,000 ÷ $2,110,000 = 5.2%, which is not less than 5%).
   2. $2,630,000. The snack shop receipts do meet the *de minimis* rule ($130,000 ÷ $2,630,000 = 4.94%, which is less than 5%).
2. (LO 2, 3, 4, 5)
   1. Purple has DPGR of $1,200, while Scarlet has none. Scarlet is not involved in any MPGE

activities.

* 1. Purple’s QPAI is $400 ($1,200 – $800). Scarlet has no QPAI.
  2. Purple has DPAD of $36 (9% × $400). Scarlet has no DPAD.

1. (LO 6) Because Campbell was a new corporation in 2013, it was automatically exempt from the corporate AMT under the small corporation exemption regardless of its amount of gross receipts. Campbell also qualifies for the small corporation exemption in 2014 as its 2013 gross receipts are $5 million or less (the $5 million gross receipts limit applies only for the second year of a new corporation). In subsequent years, Campbell calculates its average gross receipts as follows to determine whether the small business exemption is available.

|  |  |  |  |
| --- | --- | --- | --- |
| **Tax Year** | **Tax Years Used for Computation** | **Average**  **Gross**  **Receipts** | **Average Gross Receipts Computation** |
| 2015 | 2013 and 2014 | $3,150,492 | ($2,990,220 + $3,310,763) ÷ 2 |
| 2016 | 2013, 2014, and 2015 | $3,728,670 | ($2,990,220 + $3,310,763 + $4,885,027) ÷ 3 |
| 2017 | 2014, 2015, and 2016 | $5,274,157 | ($3,310,763 + $4,885,027 + $7,626,681) ÷ 3 |
| 2018 | 2015, 2016, and 2017 | $7,210,613 | ($4,885,027 + $7,626,681 + $9,120,132) ÷ 3 |

Campbell qualifies for the small corporation exemption in each of these years because its average gross receipts do not exceed the $7.5 million threshold.

1. (LO 7, 8) Alpha, Inc., has no AMT liability as its tentative minimum tax is less than its regular tax liability.

Taxable income $4,768,600

× 34%

Regular tax liability $1,621,324

AMTI $6,124,020

Less: Exemption (–0–)\* Tentative minimum tax base $6,124,020

Times: AMT rate × 20%

Tentative minimum tax before AMT foreign tax credit $1,224,804

Less: AMT foreign tax credit (62,400)

Tentative minimum tax $1,162,404

Regular tax liability (net of $62,400 foreign tax credit) $1,558,924

Alternative minimum tax $ –0–

\* AMTI exceeds $310,000; exemption is completely phased out.

1. (LO 7, 8)
   1. Calculations:

Tentative minimum tax $1,223,690

Regular tax liability (1,102,005)

Alternative minimum tax $ 121,685

Minimum tax credit carryover $ 121,685

* 1. Calculations:

Tentative minimum tax $ 976,420

Regular tax liability $ 993,014

Less: Minimum tax credit used (16,594)

Net regular tax liability $ 976,420

2017 Minimum tax credit carryover $ 121,685

Less: Minimum tax credit used (2018) (16,594)

Minimum tax credit carryover $ 105,091

1. (LO 7, 8) For regular tax, Gold uses MACRS (200% declining balance); for AMT purposes, Gold must use 150% declining balance (see Tables 3.6 and 3.7 for cost recovery factors).

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **2017** | **2018** | **2019** | **2020** | **2021 2022** |
| $40,000 | $64,000 | $38,400 | $23,040 | $23,040 $11,520 |
| $30,000 | $51,000 | $35,700 | $33,320 | $33.320 $16,660 |
| $10,000 | $13,000 | $ 2,700 | ($10,280) | ($10,280) ($ 5,140) |
| Positive | Positive | Positive | Negative | Negative Negative |

Regular tax deduction

AMT deduction

AMT adjustment

1. (LO 7, 8) The interest received from the private activity bond (tax-exempt for regular tax purposes) is an AMT tax preference. In addition, the non-deductible interest expense can be used to reduce the AMT preference. As a result, the AMT preference is $123,207 ($135,237 − $12,030).

1. (LO 7, 8)

Taxable income $6,255,012 AMT Adjustments:

* 1. Adjusted gain (loss) on property dispositions (127,055)
  2. Depreciation 280,347
  3. Certified pollution control facility (42,666)
  4. Long-term contracts 180,000

Preferences:

(1) Tax-exempt interest (private activity bonds) 27,625

AMTI before ACE $6,573,263

ACE Adjustment:

ACE $8,224,545

Less: AMTI before ACE (6,573,263)

$1,651,282

× 75%

ACE adjustment 1,238,462

AMT base $7,811,725

AMT rate × 20%

Tentative minimum tax $1,562,345

Regular tax liability ($6,255,012 × 34%) $2,126,704

Alternative minimum tax $ –0–

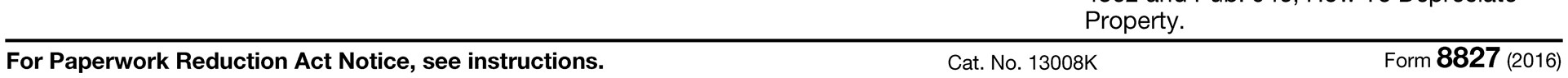
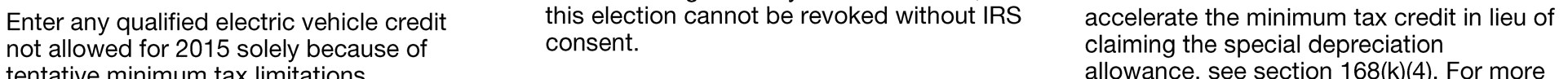
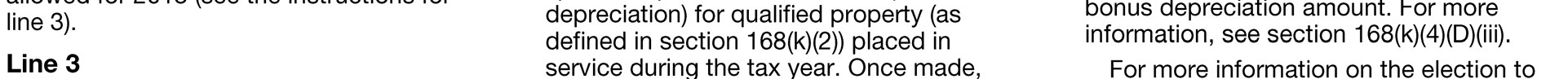
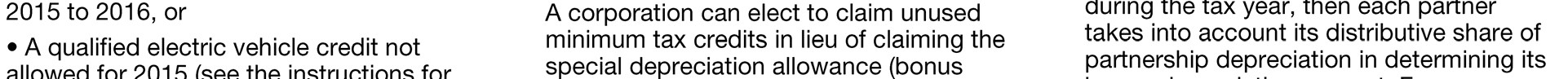
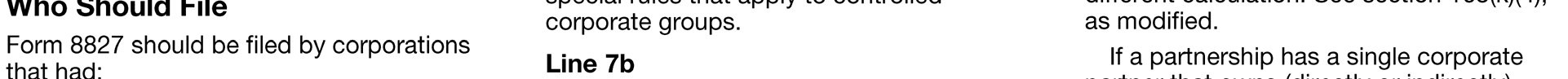
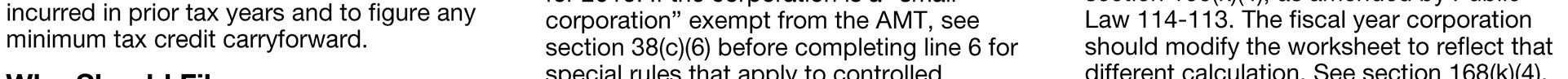
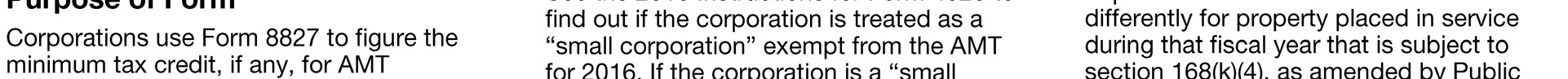
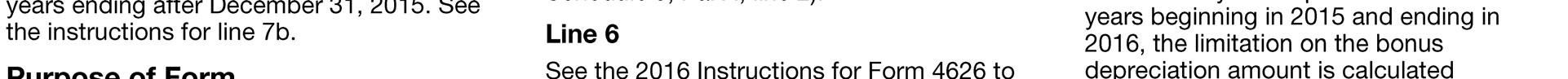
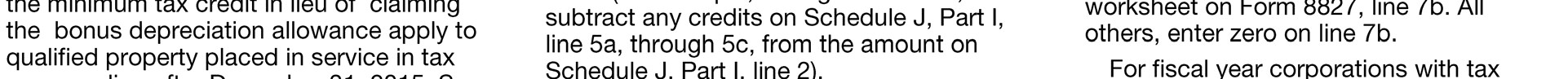
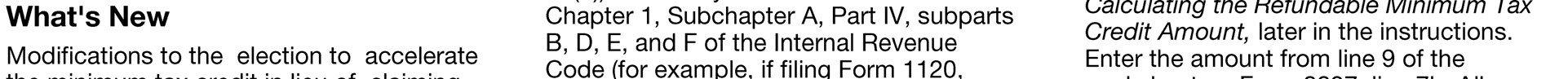
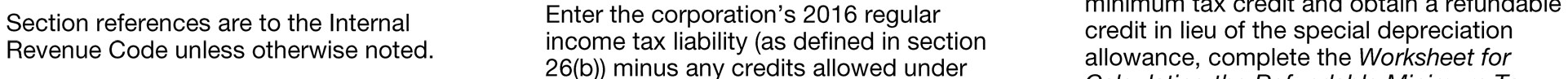
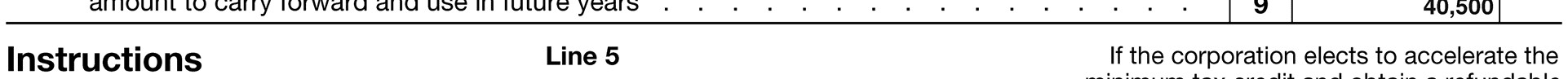
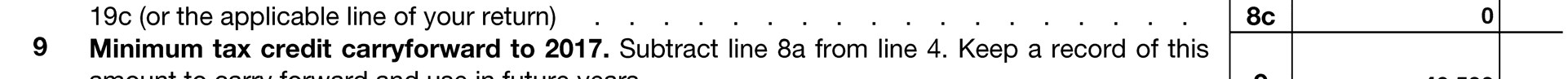
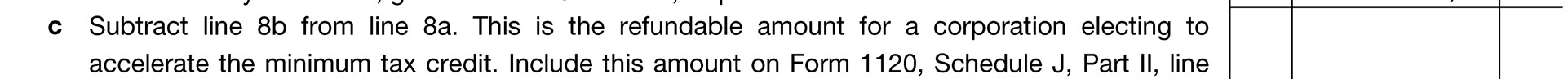
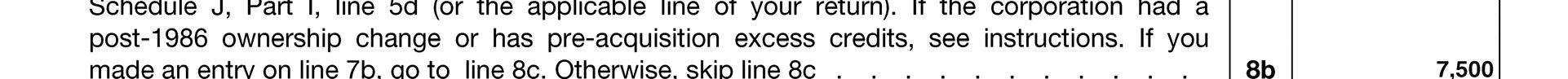
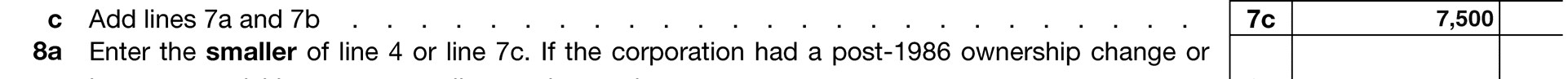
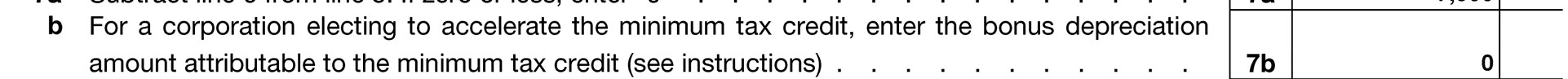
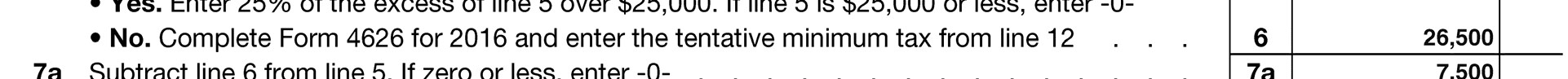
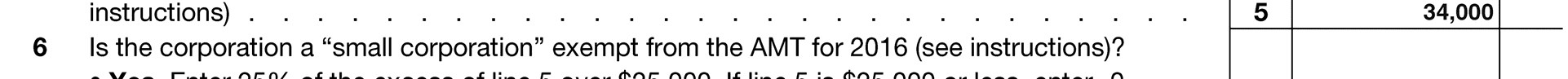
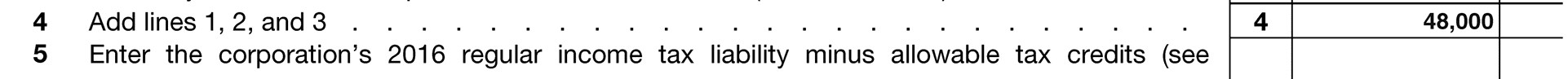
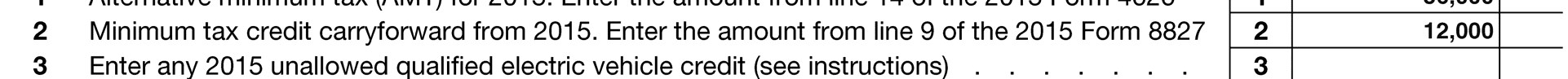
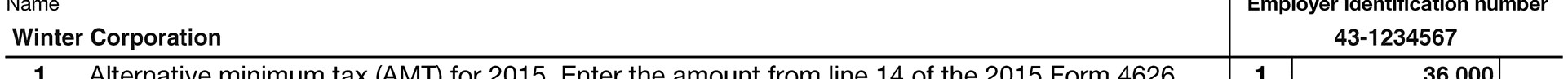
1. (LO 7, 8) The following table summarizes the regular tax and AMT deductions and AMT adjustments for Dry Hole, Inc.’s mining exploration costs:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | **Regular Tax** |  | **AMT** | |
| **Year** | **Deduction** | **Amortization** | **Total** | **Deduction** | **Adjustment** |
| 1 | $210,000 | $ 9,000 | $219,000 | $ 30,000 | $189,000 |
| 2 |  | 18,000 | 18,000 | 30,000 | (12,000) |
| 3 |  | 18,000 | 18,000 | 30,000 | (12,000) |
| 4 |  | 18,000 | 18,000 | 30,000 | (12,000) |
| 5 |  | 18,000 | 18,000 | 30,000 | (12,000) |
| 6 |  | 9,000 | 9,000 | 30,000 | (21,000) |
| 7 |  |  |  | 30,000 | (30,000) |
| 8 |  |  |  | 30,000 | (30,000) |
| 9 |  |  |  | 30,000 | (30,000) |
| 10 |  |  |  | 30,000 | (30,000) |
| Total | $210,000 | $90,000 | $300,000 | $300,000 | $ –0– |

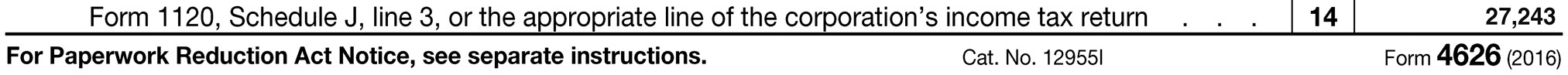
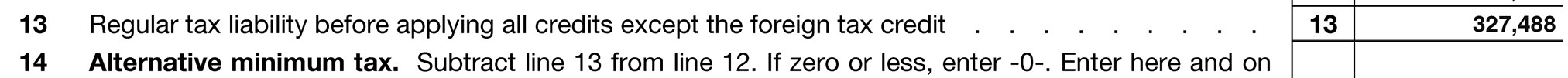
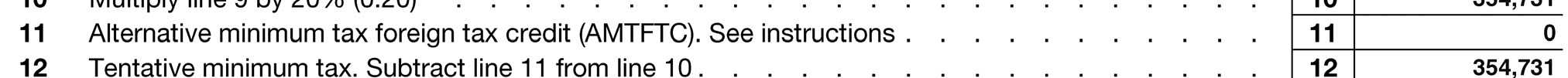
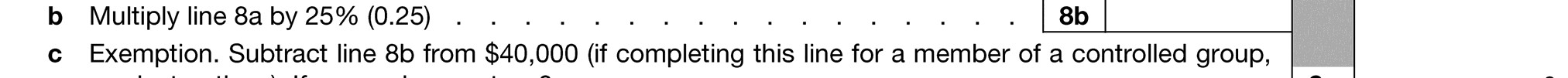
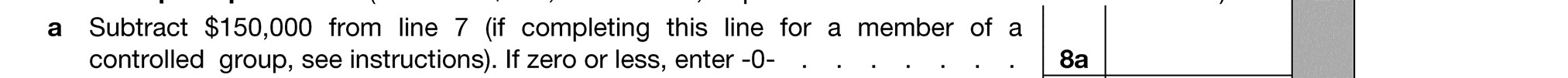
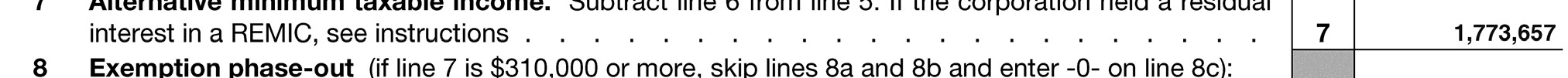
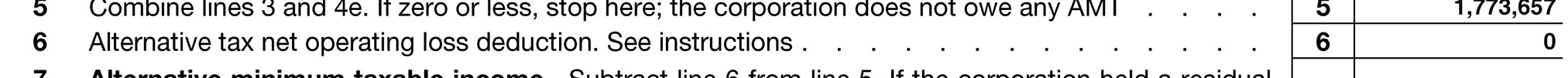
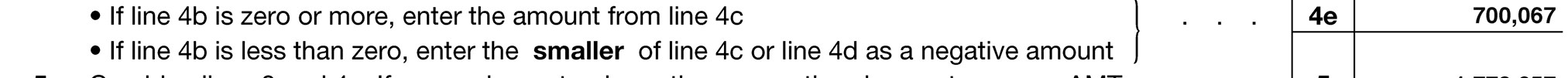
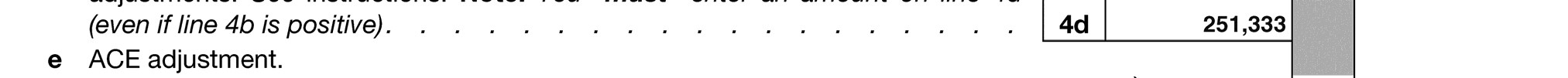
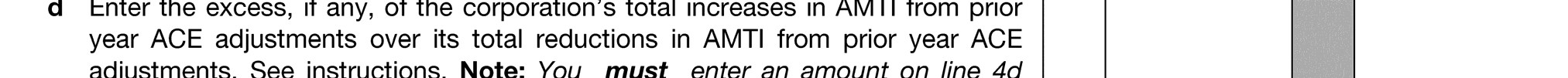
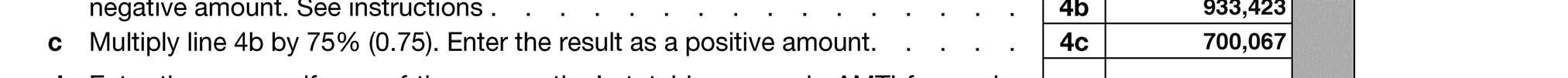
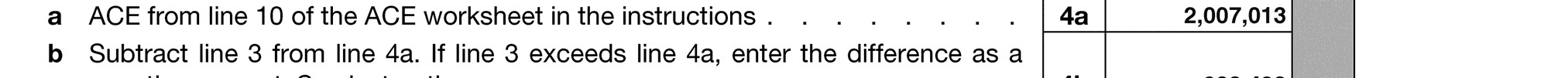
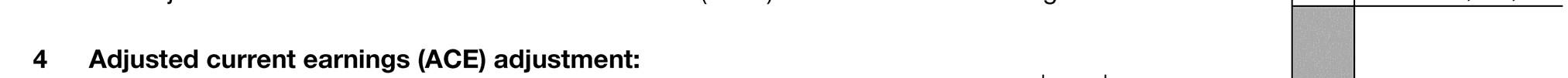
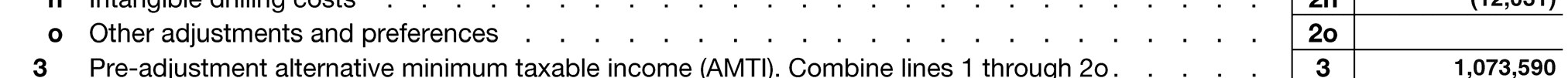
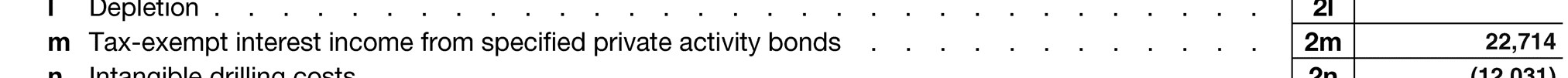
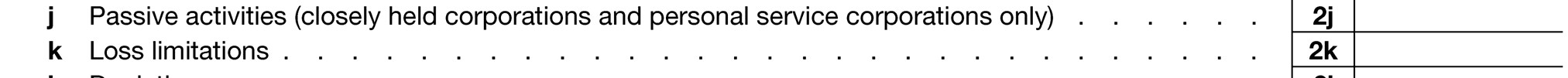
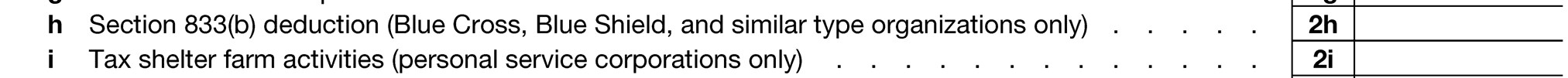
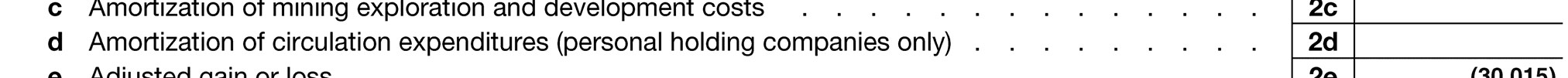
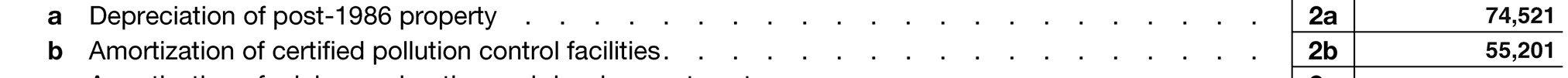
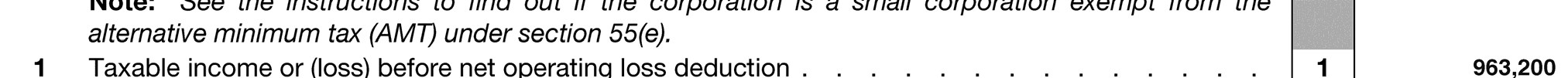
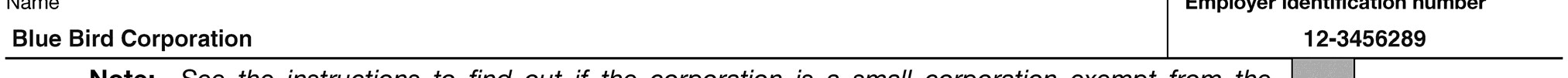
1. (LO 7, 8) The following table summarizes the regular tax and AMT deductions and AMT adjustments for PHC, Inc.’s circulation expenditures:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Regular Tax** | **A** | **MT** |
| **Year** | **Deduction** | **Amortization** | **Adjustment** |
| 1 | $33,000 | $11,000 | $22,000 |
| 2 |  | 11,000 | (11,000) |
| 3 |  | 11,000 | (11,000) |

1. (LO 7, 8) The completed Form 8827 for Winter Corporation follows:



1. (LO 7, 8) The completed Form 4626 for Blue Bird Corporation follows:



1. (LO 6, 7)
   1. Taxable income of Apple Corporation $3,600,000

Adjustments:

Accelerated depreciation on realty in excess of straight-line 1,530,000 Tax preferences:

Excess of intangible drilling costs $450,000

Percentage depletion in excess of the

property’s basis 630,000 1,080,000

Alternative minimum taxable income $6,210,000 b. AMTI (from part a. above) $6,210,000

Less: Exemption (AMTI exceeds $310,000) (–0–)

Alternative minimum tax base $6,210,000

* 1. Alternative minimum tax base (from part b. above) $6,210,000

× 20% rate × 20%

Tentative minimum tax (no foreign tax credit) $1,242,000

* 1. Tentative minimum tax (from part c. above) $1,242,000

Less: Regular tax ($3,600,000 × 34%) (1,224,000)

AMT $ 18,000

1. (LO 6, 7)
   1. Taxable income of Gold Corporation $4,200,000 Adjustments:

AMT NOL deduction (989,570)

Tax preferences:

Accelerated depreciation on pre-1987 real property $1,500,500

Excess intangible drilling costs 575,250 2,075,750

Alternative minimum taxable income $5,286,180

* 1. AMTI (from part a. above) $5,286,180

Less: Exemption (AMTI exceeds $310,000) (–0–)

Alternative minimum tax base $5,286,180

* 1. AMTI base (from part b. above) $5,286,180

20% rate × 20%

Tentative minimum tax (no foreign tax credit) $1,057,236 d. Tentative minimum tax (from part c. above) $1,057,236 Less: Regular tax ($4,200,000 × 34%) (1,428,000)

AMT $ –0–

1. (LO 6, 7)
   1. Taxable income of Silver Corporation $3,950,000

Adjustments:

AMT NOL deduction ($ 790,000)

ACE (positive) 1,500,000 710,000

Tax preferences:

Accelerated depreciation $1,240,000

Excess IDC 475,000 1,715,000

Alternative minimum taxable income $6,375,000

* 1. AMTI (from part a. above) $6,375,000

Less: exemption (AMTI exceeds $310,000) (–0–)

Alternative minimum tax base $6,375,000

* 1. AMTI base (from part b. above) $6,375,000

20% rate × 20%

Tentative minimum tax $1,275,000

* 1. Tentative minimum tax (from part c. above) $1,275,000 Less: Regular tax ($3,950,000 × 34%) (1,343,000)

AMT $ –0–

1. (LO 8) The adjustment for adjusted current earnings is 75% of the excess, if any, of the ACE over pre-adjusted AMTI.

# Negative Adjustment Positive Adjustment

1. None (a)
2. $22,500,000(b)
3. $ 7,500,000(c)
4. 15,000,000(d)
5. In 2014, Brown has a potential negative adjustment for ACE of $7,500,000 ($10,000,000 × 75%). However, since there has been no positive adjustment in a prior year, Brown is not allowed to use this negative adjustment to reduce AMTI.
6. There is a positive adjustment in 2015 of ($90,000,000 – $60,000,000) × 75% = $22,500,000.
7. In 2016, Brown is allowed a negative adjustment of $7,500,000 (75% × $10,000,000) because the positive adjustment incurred in 2015 exceeds the negative adjustments for the year.
8. Brown has a potential negative adjustment of $26,250,000 (75% × $35,000,000) in 2017. Since only $15,000,000 ($22,500,000 – $7,500,000) remains in the cumulative positive adjustments, Brown is limited to a $15,000,000 negative adjustment.
9. (LO 8)

AMTI $ 7,220,000

Plus:

Net municipal bond interest ($630,000 – $61,000) $ 569,000

Life insurance proceeds 2,000,000 Excess FIFO over LIFO 170,000

Organization expenses 200,000 2,939,000

$10,159,000

Less: Life insurance premiums (310,000)

Adjusted current earnings $ 9,849,000

1. (LO 6, 7)

Brant Corporation:

AMTI $135,000

Less: Exemption amount (no reduction; AMTI < $150,000) (40,000)

AMTI that exceeds exemption amount $ 95,000

AMT tax rate × 20% Tentative minimum tax $ 19,000 Tern Corporation:

*Step 1*

AMTI $190,000

Less (150,000)

Amount by which AMTI exceeds $150,000 $ 40,000

Reduction rate × 25% Applicable reduction in exemption amount $ 10,000

*Step 2*

Exemption amount $ 40,000

Less: Reduction in exemption amount (see Step 1) (10,000) Applicable exemption amount $ 30,000

*Step 3*

AMTI $190,000

Less: Applicable exemption amount (see Step 2) (30,000)

AMTI that exceeds exemption amount $160,000

AMT tax rate × 20% Tentative minimum tax $ 32,000

Snipe Corporation:

*Step 1*

AMTI $325,000

Less (150,000)

Amount by which AMTI exceeds $150,000 $175,000

Reduction rate × 25% Applicable reduction in exemption amount $ 43,750

*Step 2*

Exemption amount $ 40,000

Less: Reduction in exemption amount (see Step 1) (43,750) Applicable exemption amount $ –0–

*Step 3*

AMTI $325,000

Less: Applicable exemption amount (see Step 2) (–0–)

AMTI that exceeds exemption amount $325,000

AMT tax rate × 20% Tentative minimum tax $ 65,000

Note: In this case, the exemption amount phased out at $310,000.

1. (LO 8) $7,098,482. The tentative minimum tax before AMT foreign tax credit is $19,700,580 ($98,502,900 × 20%). Thus, the minimum tax is computed as follows.

Tentative minimum tax before AMT foreign tax credit $19,700,580

Less: AMT foreign tax credit (1,400,000)

Tentative minimum tax $18,300,580

Less: Regular tax (11,202,098) AMT $ 7,098,482

There is no carryover of an unused negative ACE adjustment.

1. (LO 10)
   1. $100,000. The reasonable needs of the business adjustment is only $100,000 ($3,100,000 – $3,000,000). This leaves $100,000 ($200,000 – $100,000) that needs to be paid as a dividend to make ATI equal to zero.
   2. $200,000. Here, the same reasonable needs adjustment applies as in part a. ($100,000), and leaves $200,000 to be distributed as a dividend [($300,000 – $100,000)].
   3. $0. The reasonable needs of the business have not been provided for.
   4. $500,000. The reasonable needs of the business already have been satisfied.
2. (LO 10) $243,504 ($177,480 + $66,024) or 46.6%. If a corporation qualifies for both the AET and the PHC tax, the PHC tax predominates.

Taxable income $522,000

Plus: Dividends received deduction 47,000

$569,000

Less: Federal income taxes $177,480

Excess charitable contributions 23,400 (200,880)

$368,120

Less: Dividends paid (38,000)

UPHCI $330,120

Applicable PHC tax rate × 20%

PHC Tax $ 66,024

Effective tax rate: $177,480 + $66,024 = $243,504 ÷ $522,000 = 46.6%.

# RESEARCH PROBLEMS

1. Deferred compensation costs (before the enactment of § 199) that are not part of CGS may relate to two different products. In LMSB 04-0209, the IRS Large and Mid-Size Business Division provided an acceptable method: safe harbor allocation method. Here the IRS said it would not challenge this method.

The safe-harbor method applies only to compensation expenses that:

* + Are currently deductible,
  + Relate to services provided to the taxpayer before the enactment of § 199, and
  + Are not required to be included in the taxpayer’s CGS.

1. TAX FILE MEMORANDUM

Date: March 16, 2018

From: Rob Hummock

Re: Owl, Inc., AMT/ESOP Request

The IRS will argue that the § 404(k) dividend is includible in the ACE calculation. This position was taken by the IRS in a Tax Court decision [*Snap-Drape, Inc*., 105 T.C. 16 (1995)].

The taxpayer argued that Treasury Reg. § 1.56(g)(1)(d)(3)(iii)(E), is an improper interpretation of § 56(g)(4)(C)(i), and, alternatively, that if the regulation is held valid, that the IRS abused its discretion in providing for retroactive application of the Regulation.

The Tax Court upheld the IRS, noting that the regulations in question are legislative, and thus entitled to an elevated degree of deference.

The Tax Court agreed with the IRS that “section 404(k) dividends are essentially equivalent to regular dividends,” and pointed out that generally, a corporation may not claim deductions for cash dividends. The court rejected Snap-Drape’s assertion that § 404(k) dividends are a form of compensation in that the statute exists under the deferred compensation provisions, and the benefit is ultimately received by employees.

The court stated that, in allowing corporations a deduction when their ESOPs use cash dividends to service debt incurred to acquire employer securities, Congress aimed at providing an incentive for corporations to establish ESOPs. However, the court asserted that Congress created the AMT regime “to ensure that each corporate taxpayer was in fact paying a fair share of tax.”

The IRS’s position, the court held, furthers both congressional aims, whereas Snap-Drape’s position would further only the first. The court also rejected Snap-Drape’s contention that “the regulation nullifies the benefit provided by section 404(k),” reasoning that Snap-Drape “may be entitled to claim a credit against regular tax in a subsequent year for the amount of AMT paid in the current year.”

With respect to retroactive application of Regulations, the Tax Court rejected Snap-Drape’s assertions that it justifiably relied on settled law that was altered by the Regulations and that the Regulations impose a harsh result.

3. An excellent discussion of this area can be found in R.A. Swiech and J.T. Bradford, “The AMT Depletion Preference and the Tax Court: The Decline of Mineral Taxation Erudition,” *Journal of Taxation*, December 2008, pp. 358–364.

In *Santa Fe Pacific Gold Co. and Subsidiaries ex. rel. Newmont USA* *Ltd.,* 130 T.C. 299 (2008), the IRS conceded beforehand and the court held that unamortized § 56(a)(2) costs [unamortized development and exploration costs] are added to the adjusted basis of the mineral property when calculating the § 57(a)(1) preference for percentage depletion in excess of adjusted basis. However, the Tax Court spent a great amount of didacticisms attempting to show that the IRS should not have conceded this issue.

Thus, § 614 property is not limited to the amounts directly paid to acquire the minerals (i.e., not limited to direct costs).

Further, the U.S. Tax Court held that the basis for this preference calculation is the property’s AMT basis and not its regular income tax basis. At least the IRS recognizes the separate and parallel nature of the AMT.

# Research Problems 4 and 5

*These research problems require that students utilize online resources to research and answer the questions. As a result, solutions may vary among students and courses. You should determine the skill and experience levels of the students before assigning these problems, coaching where necessary. Encourage students to use reliable websites and blogs of the IRS and other government agencies, media outlets, businesses, tax professionals, academics, think tanks, and political outlets to research their answers.*

# CHECK FIGURES

1. Taxable income: $95,000; DPAD: $8,550.
2. $82,500.
3. $3,800,000.
4. DPGR: $65; QPAI: $27.
   1. CGS: $600,000; expenses: $288,000.
   2. QPAI: $1,272,000; DPAD: $114,480.
5. AMT adjustments: Year 1 $20,000; Years 2 and 3 ($10,000).
6. 2017 AMT adjustment: $720,000.
7. $2,740 negative adjustment.
8. $22,500 exemption.
9. 2017: $417 increase; 2018: $347 increase; 2019: $510 decrease; 2020: $254 decrease.
10. 2017: $300,000 positive; 2018: no adjustment; 2019: $300,000 negative.
11. Accumulated earnings credit: $700,000; ATI: $145,000.
12. $11,600.
13. 2017, 2018: $346,500.

38.a. $54,000. 38.b. $10,000. 38.c. $72,000. 38.d. $63,000. 38.e. $30,000.

39.a. $8,200,000. 39.b. $8,600,000.

40.a. $3,000. 40.b. $3,000. 40.c. $3,000. 40.d. $3,300.

* 1. $2,600,000.
  2. $880,952.
  3. $79,286.
  4. $773,809.
  5. $69,643.

43.a. $2,000,000. 43.b. $2,630,000.

* 1. Purple, $1,200; Scarlet, none.
  2. Purple, $400; Scarlet, none.

* 1. Purple, $36; Scarlet, none.

1. All years 2013–2018.
2. Tentative minimum tax: $1,162,404; AMT: $0.
3. Minimum tax credit carryover: $105,091.
4. AMT adjustments: 2017: $10,000; 2019: $2,700; 2021: ($10,280).
5. AMT preference: $123,207.
6. Tentative minimum tax: $1,562,345; AMT

$0.

1. AMT adjustments: Year 1: $189,000; Year 4: ($12,000); Year 9: ($30,000).
2. AMT adjustments: Year 1: $22,000; Years 2 and 3: ($11,000).
3. Minimum tax credit carryover: $16,250. 54 AMT: $27,243.

55.a. $6,210,000. 55.b. $6,210,000. 55.c. $1,242,000.

55.d. $18,000.

56.a. $5,286,180. 56.b. $5,286,180. 56.c. $1,057,236.

56.d. $0.

57.a. $6,375,000. 57.b. $6,375,000. 57.c. $1,275,000.

57.d. $0.

1. 2014, no adjustment; 2015, $22,500,000; 2016, ($7,500,000); 2017, ($15,000,000).
2. $9,849,000.
3. Brant, $19,000; Tern, $32,000; Snipe, $65,000.
4. $7,098,482.

62.a. $100,000. 62.b. $200,000.

* 1. $0.
  2. $500,000.

63. PHC Tax: $66,024; Total tax: $243,504;

46.6%.

# SOLUTIONS TO ETHICS & EQUITY FEATURES

**A Proper Allocation for W–2 Wages Purposes? (p. 3-4).** Workers who have “lost” their Social Security numbers sound like undocumented (“illegal”) types. If so, Egret could be vulnerable for various fines and penalties under our immigration laws. Be that as it may, the calculation of DPAD is not proper. The allocation of labor expense to DPGR is arbitrary and does not follow any of the methods prescribed by the IRS—see pages 7 and 8 of the Instructions for Form 8903 (Domestic Production Activities Deduction). If not enough labor cost is applied against DPGR, then QPAI will be overstated. Also, DPAD cannot exceed 50% of the W–2 wages (line 19 of Form 8903) *incurred in the production* process. Thus, any W–2 wages incurred in connection with non-DPGR (the repair activity) cannot be considered.

**The Minimum Tax Credit One-Way Street (p. 3-30).** The fact that the same income may be taxed twice does not seem fair. For example, a preference item generates a regular tax in one year and results in an AMT in a later year. Unfortunately, there is no help (although a minimum tax credit is generated that can be used in *future* years). This unfairness is similar to a situation where an individual (or corporation) has extraordinary income in one or two years—surrounded by years of lower income levels. At one time, an income averaging provision was available to correct this “inequity,” but the income averaging law was repealed when the tax rates were lowered.

# SOLUTIONS TO ROGER CPA REVIEW QUESTIONS

Detailed answer feedback for Roger CPA Review questions is available on the instructor companion site (www.cengage.com/login).

1. d 4. b
2. d 5. d
3. c