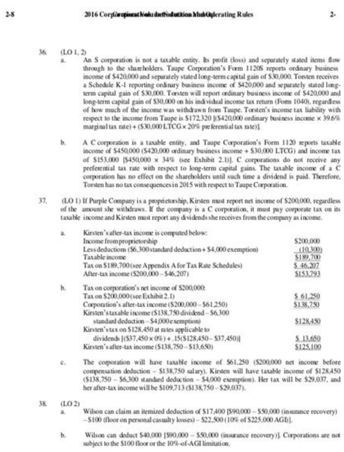

2-8 2016 Corp[illegible]erating Rules 2-

36. (LO 1, 2)
a. An S corporation is not a taxable entity. Its profit (loss) and separately stated items flow through to the shareholders. Taupe Corporation's Form 1120S reports ordinary business income of $420,000 and separately stated long-term capital gain of $30,000. Torsten receives a Schedule K-1 reporting ordinary business income of $420,000 and separately stated long-term capital gain of $30,000. Torsten will report ordinary business income of $420,000 and long-term capital gain of $30,000 on his individual income tax return (Form 1040), regardless of how much of the income was withdrawn from Taupe. Torsten's income tax liability with respect to the income from Taupe is $172,320 [($420,000 ordinary business income × 39.6% marginal tax rate) + ($30,000 LTCG × 20% preferential tax rate)].

b. A C corporation is a taxable entity, and Taupe Corporation's Form 1120 reports taxable income of $450,000 ($420,000 ordinary business income + $30,000 LTCG) and income tax of $153,000 [$450,000 × 34% (see Exhibit 2.1)]. C corporations do not receive any preferential tax rate with respect to long-term capital gains. The taxable income of a C corporation has no effect on the shareholders until such time a dividend is paid. Therefore, Torsten has no tax consequences in 2015 with respect to Taupe Corporation.

37. (LO 1) If Purple Company is a proprietorship, Kirsten must report net income of $200,000, regardless of the amount she withdraws. If the company is a C corporation, it must pay corporate tax on its taxable income and Kirsten must report any dividends she receives from the company as income.

a. Kirsten's after-tax income is computed below:

Income from proprietorship	$200,000
Less deductions ($6,300 standard deduction + $4,000 exemption)	(10,300)
Taxable income	$189,700
Tax on $189,700 (see Appendix A for Tax Rate Schedules)	$ 46,207
After-tax income ($200,000 – $46,207)	$153,793

b. Tax on corporation's net income of $200,000:

Tax on $200,000 (see Exhibit 2.1)	$ 61,250
Corporation's after-tax income ($200,000 – $61,250)	$138,750
Kirsten's taxable income ($138,750 dividend – $6,300 standard deduction – $4,000 exemption)	$128,450
Kirsten's tax on $128,450 at rates applicable to dividends [($37,450 × 0%) + .15($128,450 – $37,450)]	$ 13,650
Kirsten's after-tax income ($138,750 – $13,650)	$125,100

c. The corporation will have taxable income of $61,250 ($200,000 net income before compensation deduction – $138,750 salary). Kirsten will have taxable income of $128,450 ($138,750 – $6,300 standard deduction – $4,000 exemption). Her tax will be $29,037, and her after-tax income will be $109,713 ($138,750 – $29,037).

38. (LO 2)
a. Wilson can claim an itemized deduction of $17,400 [$90,000 – $50,000 (insurance recovery) – $100 (floor on personal casualty losses) – $22,500 (10% of $225,000 AGI)].

b. Wilson can deduct $40,000 [$90,000 – $50,000 (insurance recovery)]. Corporations are not subject to the $100 floor or the 10%-of-AGI limitation.

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