

CHAPTER 3
CORPORATIONS: SPECIAL SITUATIONS
SOLUTIONS TO PROBLEM MATERIALS

Question/ Problem	Topic	Status: Present Edition	Q/P in Prior Edition
1	The PAD as a replacement for the ETI	New	
2	PAD: nature of the tax benefit provided	New	
3	PAD: various limitations and characteristics	New	
4	PAD: effect of NOLs on the TI limitation	New	
5	PAD: effective date as to fiscal year taxpayers	New	
6	PAD: available on a passthrough basis	New	
7	PAD: prepared food prohibition	New	
8	PAD: problem of embedded services	New	
9	PAD: meaning of "significant" and "substantial"	New	
10	PAD: ownership of TPP requirement	New	
11	PAD: examples of DPGR and non-DPGR	New	
12	PAD: operation of EAG rules	New	
13	PAD: effect of passthrough provisions	New	
14	AET and PHC: LLC	Unchanged	1**
15	Factors causing AMT	Unchanged	2**
16	Adjustments and tax preferences	Unchanged	3**
17	Small corporation exemption	Unchanged	4**
18	AMT formula	Unchanged	5**
19	NOLs and AMTI	Unchanged	6**
20	ACE adjustments	Unchanged	7**
21	Effect of selected items on determination of AMTI	Unchanged	8**
22	Estimated tax for AMT	Unchanged	9**
23	Minimizing AMT	Unchanged	10**
24	Minimum tax credit	Unchanged	11**
25	PAD: relationship to AMT	New	
26	Sections 531 and 541 penalty taxes: reasons for, current status, effect of dividend distributions	New	
27	Section 531 tax and reasonable needs of the business	New	
28	Section 541 tax: avoidance through dispersion of stock ownership	New	

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<u>Question/ Problem</u>	<u>Topic</u>	<u>Status: Present Edition</u>	<u>Q/P in Prior Edition</u>
*29	PAD: QPAI, TI, and W-2 wages as limitations	New	
30	PAD: application of TI limitation	New	
31	PAD: domestic and foreign production and <i>de minimis</i> rule	New	
32	PAD: DPGR and embedded services	New	
33	PAD: DPGR and safe harbor as to foreign components	New	
34	PAD: DPGR and safe harbor as to foreign components	New	
*35	PAD: DPGR and construction projects	New	
*36	PAD: computing QPAI and simplified deduction method	New	
*37	PAD: computing QPAI and small business simplified deduction method	New	
*38	PAD: nonqualifying food services	New	
39	PAD: consequences of non-EAG status	New	
40	PAD: consequences of EAG status	New	
41	AMT liability	Unchanged	32**
42	Small corporation	Unchanged	33**
*43	Calculation of AMT liability	Unchanged	34**
*44	Calculation of ACE	Unchanged	35**
*45	Calculation of ACE	Unchanged	36**
46	Preferences or adjustments	Unchanged	37**
*47	Calculation of tentative minimum tax	Unchanged	38**
*48	Section 531: avoiding ATI through dividend distributions	New	
<u>Research Problem</u>			
1	PAD: embedded services	New	
2	PAD: meaning of "significant" and "substantial"	New	
3	ACE adjustment: ESOP dividends	Unchanged	1**
4	Personal service contract income	Unchanged	4**
5	Internet activity	Unchanged	5**
6	Internet activity	Unchanged	6**
7	Internet activity	New	

*The solution to this problem is available on a transparency master.

**Refers to the Solution Manual materials for Chapter 6 in the 2006 Edition.

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CHECK FIGURES

29.a.	\$10,000.	38.a.	\$4,000,000.
29.b.	\$18,000.	38.b.	\$5,260,000.
29.c.	\$21,000.	40.a.	\$1,600.
29.d.	\$24,000.	40.b.	\$500.
29.e.	\$27,000.	41.	\$350,000.
30.a.	\$600,000.	42.a.	Yes.
30.b.	\$550,000.	42.b.	No.
31.a.	\$4.1 million.	42.c.	Yes.
31.b.	\$4.3 million.	43.a.	\$7.9 million.
32.a.	\$2,000.	43.b.	\$7.9 million.
32.b.	\$2,100.	43.c.	\$1.58 million.
32.c.	\$2,000.	43.d.	\$0.
33.a.	\$1,400.	44.	2004, \$0; 2005, \$22.5 million; 2006, (\$7.5 million); 2007, (\$15 million).
33.b.	\$380.	45.	\$9.66 million.
34.a.	\$0.	47.	Brant, \$27,000; Tern, \$32,000; Snipe, \$65,000.
35.	Robert, \$0; Cardinal, \$2.8 million; architect, \$400,000; Dove, \$500,000.	48.a.	\$100,000.
36.a.	\$2,500,000.	48.b.	\$200,000.
36.b.	\$1,000,000.	48.c.	\$0.
36.c.	\$30,000.	48.d.	\$500,000.
37.a.	\$906,250.		
37.b.	\$27,188.		

DISCUSSION QUESTIONS

1. a. The U.S. income tax on corporations is highly progressive when compared to taxes imposed by other nations. In fact, many countries do not even levy a corporate income tax. Consequently, Congress has enacted many provisions in the past (e.g., DISC, FSC, ETI) that place U.S. corporations in a more competitive position in international trade settings. When the WTO held the ETI regimen to be an illegal export subsidy, Congress replaced it with § 199 and the PAD. The effect of the PAD is to lessen the impact of high corporate income tax rates. PAD, therefore, has the same objective as the ETI and, in this regard, can be considered as a replacement.
- b. Unlike the ETI, § 199 is not directed to foreign trade activities. To the contrary, the § 199 deduction is based on *domestic* production gross receipts. As such, it benefits all U.S. producers and is not conditioned on income derived from the exporting of manufactured goods. Because of the broad scope of § 199, it cannot be treated as a replacement for the ETI, which only favored exporters.

pp. 3-2 and 3-3

2. PAD is a deduction that is determined in a unique manner. Unlike most deductions that are generated by expenditures, PAD is based on income. If certain production activities produce a profit, PAD is a percentage of that profit. Consequently, the larger the profit, the larger the deduction. Of course, the profit increases the income tax, while the deduction reduces the income tax! p. 3-3
3. a. PAD is a percentage (3%, 6%, or 9%—depending on the year involved) of the *lesser of* QPAI or TI, but not to exceed 50% of W-2 wages.
- b. PAD cannot exceed 50% of W-2 wages.
- c. PAD is limited to a percentage of TI if less than the percentage of QPAI.
- d. DPGR, when reduced by CGS and direct and indirect expenses, becomes QPAI.
- e. When an EAG is involved, PAD is determined as if the group is a single corporation.
- f. PAD is allowed for purposes of the AMT.

Figure 3-1 and Examples 2, 3, and 4

4. Although passed in late 2004, § 199 is not effective until tax years starting after 2004. Thus, it was not available to Khaki Corporation for its tax year 2004. Why was § 199 not used for tax year 2005? A number of reasons are possible, but the most likely is the taxable income limitation. As Khaki did not show a profit until 2004, tax years 2001 through 2003 probably were loss years. NOLs for these years are carried forward and will offset any profits for 2004 and 2005. With TI being zero, no PAD is available. Example 2
5. Yes, there is a reasonable explanation. Sand Company probably is a fiscal year partnership. Therefore, it will not be able to use § 199 until fiscal year 2005–2006. Any passthrough of QPAI occurs in 2006 and will not be available to calendar year partners, such as Heather, until they file their 2006 returns. Example 24
6. Yes, Brad might be able to claim a PAD. If Brad is a shareholder in an S corporation or a partner in a partnership (or both) that qualifies under § 199, the PAD attributes will pass through to him. Since the PAD is a deduction *for* AGI, it does not matter that Brad claims the standard deduction. pp. 3-3 and 3-14

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7.
 - a. 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.
 - b. No, it would not matter. Prop. Reg. § 1.199-3(n) makes it quite clear that take-out and delivery services will be treated the same as prepared meals served on the premises.

p. 3-13
8.
 - a. When the sale of a product entails the rendition of a service regarding that product, the service element is embedded in the selling price.
 - b. Examples of embedded services include product warranties, maintenance arrangements, training in product use, and customer call-in assistance.
 - c. When the embedded service is not separately priced or when its cost meets a 5% *de minimis* test, it can be included in DPGR.

p. 3-7 and Example 8
9.
 - a. DPGR refers to *domestic* production. Foreign production is allowed, however, but only if the domestic portion remains “significant.”
 - b. 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.
 - c. The problem will arise quite frequently since the components of many U.S. goods are produced by foreign affiliates.

p. 3-8 and Examples 9 and 10
10. Only the party that has ownership of the property being produced can claim the PAD.
 - a. Much manufacturing takes place on a contract basis with more than one party participating in the production process. Consequently, those who do not have title to the property will not be able to claim the PAD.
 - b. Title to the property should be placed with the taxpayer that wants to claim the PAD.

p. 3-9 and Examples 11 and 12
11.
 - a. No. The engineering services have to be performed in connection with real estate construction projects located *within* the U.S. See Prop. Reg. § 1.199-3(m)(2).
 - b. No. Unless the taxpayer has ownership of the carts, the PAD is not available in contract manufacturing type of situations [Prop. Reg. § 1.199-3(e)(1)]. Here, it is not likely that the taxpayer has title to the property.
 - c. No. The taxpayer is not in the construction business.
 - d. Yes. Ownership of the property is not necessary in the case of construction activities. Example 15

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- e. Yes in part. Only the receipts from generating the electricity are DPGR—receipts from its transmission and sale to customers do not qualify. If the gross receipts cannot be separately identified, an allocation to the various sources will be necessary. Example 17
12. Normally, Amber would qualify for the PAD, and Orange would not (marketing and selling activities are not MPGE). If the EAG rules apply, however, Amber's activities are now attributed to Orange. Thus, the total profit now becomes QPAI and is eligible for the PAD. Examples 22 and 23
13. The most likely reasons why Kathleen has a lower PAD would be due to the taxable income or W-2 wage limitations. She might have some losses that offset the QPAI that passes through. Also, the W-2 wage passthrough from Red might not, by itself, be enough to allow the full PAD to be used. But Brad has other W-2 wages he can count to allow for a larger PAD than Kathleen. pp. 3-4 and 3-14
14. The objective of the AMT is to force taxpayers who are more profitable than their taxable income reflects to pay additional income taxes under a parallel system. pp. 3-14 and 3-15
15. In general, a corporation is likely to pay AMT for one or more of these reasons:
- A high level of investment in assets such as equipment and structures.
 - Low taxable income due to a cyclical downturn, strong international competition, a low-margin industry, or other factors.
 - Investment at low real interest rates, which increases the company's deductions for depreciation relative to those for interest payments.
- p. 3-15
16. This statement is incorrect. Many of the adjustments and tax preference items necessary to arrive at AMTI are the same. p. 3-15
17. Certain corporations that meet several gross receipts tests are exempted from the AMT as long as they *remain* "small corporations." A corporation initially qualifies as a "small corporation" if it had *average* gross receipts of \$5 million or less in the preceding three-year period. If a corporation is not in existence for the entire three-year period, the \$5 million test is applied for the period the corporation was in existence. A corporation that initially passes the \$5 million average gross receipts test will continue to be treated as a small corporation as long as its *average* gross receipts for the three-year period preceding the taxable year do not exceed \$7.5 million. p. 3-15
18. The formula is incorrect. Some adjustments are positive as well as negative, and the ACE adjustment may be positive (as well as negative). Figure 3-2
19. Although an NOL is an adjustment, it is separately stated on Form 4626 because it may not exceed more than 90% of AMTI. p. 3-16 and Figure 3-2
20. a. N. (No impact)
b. I. (Add)

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- c. N. (No impact)
- d. N. (No impact)
- e. I. [Add (net of cash surrender value previously accounted for)]
- f. I. (Add)
- g. I. (Add)
- h. N. (No impact)

Concept Summary 3-1

- 21. a. E. Both positive and negative. p. 3-17
- b. E. Both positive and negative. Figure 3-3
- c. E. Plus or minus adjustment. p. 3-17
- d. D. p. 3-16 and Figure 3-2
- e. D. p. 3-21 and Figure 3-2
- f. E. Plus or minus adjustment. p. 3-17
- g. I. A tax preference item. p. 3-18
- h. N.
- i. I. A tax preference item. p. 3-18

- 22. February 10, 2006

TAX FILE MEMORANDUM

SUBJECT: Robert Barrack
Estimated payments for AMT

I told Mr. Barrack over the phone that corporations do have to make estimated tax payments for any AMT liability. Even if his company prepares quarterly financial statements, compliance costs may be increased. The AMT as finally determined will be reported on Form 4626. p. 3-22

- 23. The corporation should consider several strategies to avoid or minimize the AMT:
 - Investments could be switched to state or local bonds because the interest is not includible in gross income. Avoid private-activity bonds that are taxable under the AMT.
 - Capitalizing rather than expensing certain costs (e.g., circulation expenditures, mining exploration and development costs) can avoid generating preferences and adjustments.

- The corporation should attempt to avoid bunching positive adjustments and tax preferences in any one year.
- If a corporation expects to be subject to the AMT, accelerate income and defer deductions for the remainder of the year.
- During an AMT year, sell any major assets to obtain the favorable 20% AMT rate.

p. 3-26 and Example 37

24. The AMT is a separate tax system that is computed side-by-side with the regular tax. Along with the "netting concept," a minimum tax credit is available to eliminate the possibility of double taxation. Essentially, the AMT paid in one tax year may be carried forward indefinitely and used as a credit against the corporation's future *regular* tax liability that exceeds its tentative minimum tax. The minimum tax credit may not be carried back and may not be offset against any future *minimum* tax liability. p. 3-22
25. Yes, the PAD is allowed for AMT purposes. In the case of individual taxpayers, the PAD is calculated the same way for both purposes (i.e., regular income tax and AMT). For other taxpayers, the deduction is the applicable percentage (3%, 6%, or 9%) times the lesser of QPAI or AMTI (calculated without any PAD adjustment). pp. 3-14 and 3-16
26. a. The original purpose for the § 531 and § 541 taxes was to penalize corporations that accumulated profits and avoided dividend distributions. In such situations, the corporation was being used by its shareholders to defer and minimize (and in some cases, avoid) taxes.
- b. Since dividends are no longer taxed as ordinary income but are subject to the same rates applicable to long-term capital gains, their distribution does not entail severe tax consequences. Furthermore, the penalty imposed on corporations that come under § 531 or § 541 is no longer based on the highest tax rate imposed on individuals (i.e., currently 35%), but is a much milder 15%.
- c. The § 531 tax is imposed on ATI, and the § 541 tax is imposed on undistributed PHC income. In arriving at both of these amounts, a deduction is allowed for dividends paid. Thus, the payment of enough dividends will reduce both amounts to zero and both taxes are avoided.

pp. 3-22 and 3-23

27. In arriving at the credit for reasonable needs of the business, the beginning balance in accumulated E & P must be taken into account. Consequently, this beginning balance would have to be \$200,000 or less for Fuchsia to be entirely covered. However, any amount not covered can be neutralized by a dividend distribution. (See the discussion of ATI in the solution to Question 26.c. above.) pp. 3-23 and 3-24
28. Yes. The imposition of the § 541 tax requires that the corporation meet the definition of a personal holding company. One part of this definition is the satisfaction of the stock ownership test. Therefore, if enough nonrelated parties own shares (in terms of value) in the corporation, it is not a personal holding company and any penalty tax is avoided. p. 3-24

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PROBLEMS

29. a. \$10,000. The W-2 limitation of \$10,000 ($50\% \times \$20,000$) is less than the QPAI computation of \$12,000 ($3\% \times \$400,000$). Example 3
- b. \$18,000. The taxable income limitation of \$18,000 ($3\% \times \$600,000$) is less than the QPAI computation of \$24,000 ($3\% \times \$800,000$) and is under the W-2 limitation of \$50,000 ($50\% \times \$100,000$). Example 1
- c. \$21,000. The QPAI computation of \$21,000 ($3\% \times \$700,000$) is less than the taxable income limitation of \$27,000 ($3\% \times \$900,000$) and is under the W-2 limitation of \$100,000 ($50\% \times \$200,000$). Example 4
- d. \$24,000. After the NOL carryover of \$100,000, taxable income becomes \$800,000 ($\$900,000 - \$100,000$). Now, the taxable income limitation of \$24,000 ($3\% \times \$800,000$) is less than the QPAI computation of \$27,000 ($3\% \times \$900,000$) and is under the W-2 limitation of \$150,000 ($50\% \times \$300,000$). Example 2
- e. \$27,000. The QPAI computation of \$27,000 ($3\% \times \$900,000$) is the same as the taxable income limitation of \$27,000 ($3\% \times \$900,000$) and is under the W-2 limitation of \$100,000 ($50\% \times \$200,000$). For purposes of the W-2 limitation, the wages considered do not have to relate to the manufacturing activities. p. 3-5
30. a. \$600,000.
- b. Even though QPAI is \$600,000, TI is \$550,000 ($\$600,000 - \$50,000$). Thus, PAD for 2006 is \$16,500 ($3\% \times \$550,000$) since it is less than \$18,000 ($3\% \times \$600,000$). For 2008, PAD is \$33,000 ($6\% \times \$550,000$), and for 2010, PAD is \$49,500 ($9\% \times \$550,000$).

Example 1 and Footnote 4

31. a. Kingfisher's DPGR is \$4.1 million. The \$1 million derived from the Honduras facility cannot be included under the *de minimis* rule, as the amount exceeds 5%— $\$1 \text{ million} / \$5.1 \text{ million} = 19.6\%$. Example 6
- b. Kingfisher's DPGR now becomes \$4.3 million. The \$200,000 from Honduras is included under the *de minimis* rule— $\$200,000 / \$4.3 \text{ million} = 4.65\%$, which is less than 5%. Example 7
32. a. Although the basic warranty is an embedded service, it is not separately priced or bargained for and is included as part of the cost of the product. Therefore, the full \$2,000 is DPGR.
- b. The full \$2,100 is DPGR under the *de minimis* rule. $\$100 / \$2,100 = 4.76\%$, or less than 5%.
- c. Only \$2,000 is DPGR as the \$200 embedded service does not come within the *de minimis* rule— $\$200 / \$2,200 = 9.1\%$, or not less than 5%.
- d. If the price of the product was raised to \$2,200 and every item sold was under a 10-year warranty, the full amount might be DPGR. Thus, the extended warranties would not be separately priced or bargained for.

p. 3-7 and Example 8

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33. a. The full \$1,400 selling price represents DPGR. The foreign components (\$800) can be included as the domestic source contribution (\$200) represents at least 20% (\$200/\$1,000) of CGS and meets the safe harbor rule.
- b. QPAI is \$380 (\$1,400 – \$800 – \$200 – \$20).

Example 9

34. a. As 17.5% (\$170/\$970) is less than 20%, the safe harbor test is not met. Therefore, DPGR and QPAI are both zero and there is no PAD.
- b. Swallow should increase its production cost enough to satisfy the safe harbor test. As noted in Problem 33, an extra \$30 to make \$200 will suffice—\$200/\$1,000 = 20%.

Example 10

35. DPGR is as follows:

Robert	\$	0
Cardinal Corporation	\$2.8 million	
Architect	\$	400,000
Dove Electric Company	\$	500,000

As Robert does none of the construction, he has no DPGR. When construction is involved, title to the property being renovated is of no consequence—contrast the rule applying to manufacturing situations. p. 3-10 and Example 15

36. a. \$2,500,000. DPGR cannot include gross receipts from the resale of imported goods.
- b. To determine selling, marketing, and administrative expenses allocable to DPGR, use the fraction based on DPGR/total gross receipts. Therefore, \$2.5 million/\$4 million × \$800,000 = \$500,000. QPAI is

DPGR	\$ 2,500,000
CGS	(1,000,000)
Other expenses	(500,000)
QPAI	<u>\$ 1,000,000</u>

- c. PAD is \$30,000 (3% × \$1,000,000).

p. 3-12

37. a. 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	\$ 2,500,000
Less allocated CGS	
\$2.5 million/\$4 million × \$1,750,000	(1,093,750)
Less allocated other expenses	
\$2.5 million/\$4 million × \$800,000	(500,000)
QPAI	<u>\$ 906,250</u>

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b. PAD is \$27,188 ($3\% \times \$206,250$).

Example 18

38. a. \$4,000,000. The snack shop receipts *do not* meet the *de minimis* rule— $\$220,000 / \$4,220,000 = 5.2\%$, which is not less than 5%.
- b. \$5,260,000. The snack shop receipts *do* meet the *de minimis* rule— $\$260,000 / \$5,260,000 = 4.94\%$, which is less than 5%.

Examples 20 and 21

39. a. Violet has DPGR of \$1,000, while Scarlet has none. Scarlet is not involved in any MPGE activities.
- b. Violet's QPAI is \$200 ($\$1,000 - \800). Scarlet has no QPAI.
- c. If 2005 or 2006 is involved, Violet has PAD of \$6 ($3\% \times \200). Scarlet has no PAD.

Example 23

40. a. DPGR is \$1,600.
- b. QPAI is \$500 ($\$1,600 - \$800 - \300).

Example 22

41. $\$293,000 + \$57,000 = \$350,000$. The IRS cannot impose both the AET and the PHC tax. p. 3-15 and Figure 3-2
42. a. Yes, Gold is a small corporation because it did pass the \$5 million average gross receipts test for the basic qualification year.
- b. Silver is not a small corporation because the average gross receipts of \$5.016 million exceeds the \$5 million test [$(\$4.6 \text{ million} + \$5.5 \text{ million} + \$4.95 \text{ million}) / 3 = \5.016 million].
- c. Yes, Copper is a small corporation because the company meets the \$5 million test [$(\$4.7 \text{ million} + \$4.9 \text{ million} + \$5.12 \text{ million}) / 3 = \$4,906,667$].

p. 3-15

43. a.	Taxable income of Mallard Corporation	\$ 5,000,000		
	Adjustments:			
	Accelerated depreciation on realty in excess of straight-line	1,700,000		
	Tax preferences:			
	Tax-exempt interest on municipal bonds	\$500,000		
	Percentage depletion in excess of the property's basis	700,000		
	Alternative minimum taxable income	<table border="0" style="margin-left: auto;"> <tr> <td style="border-top: 1px solid black; border-bottom: 3px double black;">1,200,000</td> </tr> <tr> <td style="border-bottom: 3px double black;">\$ 7,900,000</td> </tr> </table>	1,200,000	\$ 7,900,000
1,200,000				
\$ 7,900,000				

Example 31

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b.	AMTI (from part a. above)	\$ 7,900,000
	Less: Exemption (AMTI exceeds \$310,000)	(-0-)
	Alternative minimum tax base	<u>\$ 7,900,000</u>

Example 32

c.	Alternative minimum tax base (from part b. above)	\$ 7,900,000
	× 20% rate	× 20%
	Tentative minimum tax (no foreign tax credit)	<u>\$ 1,580,000</u>

Figure 3-2

d.	Tentative minimum tax (from part c. above)	\$ 1,580,000
	Less: Regular tax (\$5,000,000 × 34%)	(1,700,000)
	AMT	<u>\$ -0-</u>

Figure 3-2

44. The adjustment for adjusted current earnings is 75% of the excess, if any, of the ACE over pre-adjusted AMTI.

	<u>Negative Adjustment</u>	<u>Positive Adjustment</u>
2004(a)		
2005		\$22,500,000(b)
2006	\$ 7,500,000(c)	
2007	15,000,000(d)	

- (a) 2004 has a potential negative adjustment for ACE. Since there has been no positive adjustment in a prior year, Purple is not allowed to use this negative adjustment to reduce AMTI.
- (b) There is a positive adjustment in 2005 of $(\$90,000,000 - \$60,000,000) \times 75\% = \$22,500,000$.
- (c) In 2006, Purple is allowed a negative adjustment of \$7,500,000 ($75\% \times \$10,000,000$) because the positive adjustment incurred in 2005 exceeds the negative adjustments for the year.
- (d) Purple has a potential negative adjustment of \$30,000,000 ($75\% \times \$40,000,000$) in 2007. Since only \$15,000,000 ($\$22,500,000 - \$7,500,000$) remains in the cumulative positive adjustments, Purple is limited to a \$15,000,000 negative adjustment.

Figure 3-3 and Example 30

45.	AMTI		\$7,120,000
	Plus:		
	Net municipal bond interest	\$ 580,000	
	Life insurance proceeds	2,000,000	
	Excess FIFO over LIFO	160,000	
	Organization expenses	100,000	
		<u>2,840,000</u>	
			\$9,960,000
	Less: Life insurance expense		(300,000)
	Adjusted Current Earnings		<u>\$9,660,000</u>

Example 31

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- 46. a. Preference. p. 3-18
- b. Adjustment. p. 3-17
- c. Adjustment. p. 3-17
- d. Adjustment. p. 3-17
- e. Preference. p. 3-18
- f. Not applicable. Figure 3-2
- g. Not applicable. Figure 3-2
- h. Not applicable. p. 3-16

47. Brant Corporation:

AMTI	\$170,000
Less: Exemption amount	(35,000)
AMTI that exceeds exemption amount	<u>\$135,000</u>
Rate	× 20%
Tentative minimum tax	<u><u>\$ 27,000</u></u>

Tern Corporation:

Step 1

AMTI	\$ 190,000
Less	(150,000)
Amount by which AMTI exceeds \$150,000	<u>\$ 40,000</u>
Reduction rate	× 25%
Applicable reduction in exemption amount	<u><u>\$ 10,000</u></u>

Step 2

Exemption amount	\$ 40,000
Less: Reduction in exemption amount (see Step 1)	(10,000)
Applicable exemption amount	<u><u>\$ 30,000</u></u>

Step 3

AMTI	\$ 190,000
Less: Applicable exemption amount (see Step 2)	(30,000)
AMTI that exceeds exemption amount	<u>\$ 160,000</u>
Rate	× 20%
Tentative minimum tax	<u><u>\$ 32,000</u></u>

Snipe Corporation:

Step 1

AMTI	\$ 325,000
Less	(150,000)
Amount by which AMTI exceeds \$150,000	<u>\$ 175,000</u>
Reduction rate	× 25%
Applicable reduction in exemption amount	<u><u>\$ 43,750</u></u>

Step 2

Exemption amount	\$ 40,000
Less: Reduction in exemption amount (see Step 1)	(43,750)
Applicable exemption amount	<u><u>\$ -0-</u></u>

Step 3

AMTI	\$ 325,000
Less: Applicable exemption amount (see Step 2)	(-0-)
AMTI that exceeds exemption amount	<u>\$ 325,000</u>
Rate	× 20%
Tentative minimum tax	<u><u>\$ 65,000</u></u>

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

p. 3-21, Example 32, and Figure 3-2

48. a. \$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.
- b. \$200,000. Here, the same reasonable needs adjustment as in part a. leaves \$200,000 to be distributed as a dividend.
- c. \$0. The reasonable needs of the business has not been provided for.
- d. \$500,000. The reasonable needs of the business already has been provided for.

Examples 35 and 36

The answers to the **Research Problems** are incorporated into the *2007 Corporations Volume of the Instructor's Guide with Lecture Notes to Accompany WEST FEDERAL TAXATION: CORPORATIONS, PARTNERSHIPS, ESTATES & TRUSTS*.