“C” - CORPORATION

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BY

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Each tax preparer must depend on his or her own knowledge of the law and expertise in the use or the modification of these materials.

Preparers must be aware that the laws are constantly changing and that the information in this manual may be superceded at any time.

This course is for the assistance to take the preparer to the client's personal income tax return and is not a study in and of itself for the preparation of corporation returns.

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CORPORATE STRUCTURE

GENERAL ATTRIBUTES OF CORPORATION

- ✓ Unlimited life
- ✓ Shares fully transferable (generally)
- ✓ Shareholders limited liability and cannot lose more than investment
- ✓ Managed by Board of Directors, not stockholders, so can raise money by selling stock without fear of interference in management.
- ✓ Reasonable salary paid to employee-shareholder is deductible by Corp.
- ✓ Retirement and employee benefits can be more generous to corporate employee than sole proprietor or partner.
- ✓ Corporation IS a taxpayer - an entity in itself. Profits, losses and credits are NOT passed through to stockholders. (Unless S Corp)
- ✓ Requires consent of State of Incorporation
- ✓ Requires certain records to be kept.
- ✓ Requires meetings to be held at certain times.
- ✓ Must pay State and Federal income tax (except S Corp)
- ✓ Quarterly estimated tax payments required.
- ✓ After tax earnings:
  - Retained - appreciated stock values taxed to shareholders later
  - Paid to Stockholders as dividends -cash dividend up to accumulated earnings and profits.
- ✓ Distributions if no earnings and profits are tax free distributions to extent of basis of stockholder - balance is capital gain
- ✓ Penalty tax on excess accumulated earnings.

CORPORATE STRUCTURE

Corporation must have reasonable business need and definite plan for use

- ✓ business expansion plans
- ✓ plant replacement
- ✓ business acquisitions
- ✓ product liability loss reserves
- ✓ stock redemption plans
- ✓ working capital needs
- ✓ retirement of debt
- ✓ funding for non-qualified retirement plan

ORGANIZING A CORPORATION

DEFINITION:

A corporation is a legal entity, artificial or fictitious, existing only in contemplation of law.

A separate entity with special powers defined by law.

NAME

A corporation must have a name ending in "Inc.", "Corp", "Ltd" or something else indicating its corporate nature.

Must be a name not used by another corporation in the state, or at least not used by a corporation whose line of business is similar enough to cause confusion.

Assumed business name application must be filed. The Model Business Corporations Act allows a business to reserve the name it wants to use, for up to 120 days in the pre-incorporation period.

TYPES OF CORPORATIONS

- STOCK CORPORATION:
  Organized to carry on a business for profit, to distribute profits as dividends to shareholders, and distribute its assets to shareholders when dissolved.

- NON-STOCK OR NON-PROFIT CORPORATION
  Does NOT distribute gains or profits to members.
  Corporation where individuals associate together for religious, charitable, social, educational, or cemetery purposes, or rendering services subject to that particular class of nonprofit activity.

THIS COURSE DISCUSSION WILL GENERALLY BE BASED ON THE 'CLOSE STOCK' CORPORATION.
THIS CORPORATION IS ONE OWNED BY ONE PERSON OR A SMALL NUMBER OF PEOPLE AND THESE SAME PEOPLE ARE ALSO THE DIRECTORS

WHO MAY INCORPORATE

Any person or group of persons over the age of 18.
Who file required article of incorporation and pay proper fees

ORGANIZING A CORPORATION

STATE OF INCORPORATION

Most states are now governed by the Model Business Corporations Act drafted by the ABA's Committee on Corporate Laws, so it is unusual for one to state to be exceptionally favorable or unfavorable to corporations.

Consideration should, however, be given to State laws concerning:

Minimum stated capital required
Restrictions on no-par stock;
State regulation of corporate documents
Blue Sky laws
Limits on convertibility of debt and equity instruments
Dividends
Liquidating dividends
Laws permitting shareholder actions
Laws on immunity of officers and directors
Sales tax existence
Inventory tax existence;
Local real estate tax rates
State excise taxes
Prevailing wage rates
State unemployment rates
Worker's compensation rates
Restrictions on acquisitions, mergers and consolidations.

FOREIGN CORPORATION - DOING BUSINESS IN ANOTHER STATE

Although a proprietorship or partnership can enter another state freely (subject to that state's income, sales and use taxes) ----

A CORPORATION INCORPORATED IN ONE STATE NEEDS PERMISSION FROM ANOTHER STATE TO DO BUSINESS IN THAT STATE.

Must apply for Certificate of Authority.

Once Certificate is issued and required fee paid:

- Must maintain a registered agent in the state.
- Can be sued in that state
- Must pay franchise and/or income taxes and sales and use taxes.

INCORPORATING A BUSINESS CORPORATION

A copy of the **Oregon** Business Corporation Act, Chapter 57, can be obtained free from:

Corporation Commissioner
255 Capitol St. NE, Suite 151
Salem, OR 97310-1327
Telephone (503) 986-2200
http://www.filinginoregon.com/index.htm - Oregon Business Guide

A copy of the **Washington** Business Corporation Act can be obtained from:

Office of the Secretary of State
P.O. Box 40234
Olympia, WA 98504-0234
or
Dolliver Building
801 Capitol Way South
Olympia, WA
http://apps.leg.wa.gov/rcw/

A copy of the **California** Corporations Code may be obtained from:

Office of the Secretary of State
1500 11th Street
Sacramento, California 95814
Phone (916) 657-5448
http://www.leginfo.ca.gov/calaw.html

CORPORATE NAME

OREGON

- Shall contain the word "corporation", "company", "incorporated" or "limited" or abbreviation of one of such words.

- Shall not contain any word or phrase which indicates or implies that it is organized for any purpose other than one or more of the purposes contained in its articles of incorporation.

- Shall not be the same as, or deceptively the similar to, any other corporation, limited partnership, reserved or registered name currently on file with the Corporation Commissioner, Insurance Commissioner, or Superintendent of Banks, an assumed business name registered with the Corporation or a trade-mark, trade-name or service mark registered with the Corporation commissioner.

  Exception: Written consent of such other holder
  or certified copy of final decree of court establishing
  prior right of applicant to use such name.

CHECK TO FIND OUT IF NAME IS REGISTERED:

For Oregon: Contact Corporation Commissioner at address above

For Washington: Certificate of Trade Name does not give you exclusive use of the trade name so no need to check to find out if registered.

For California: County Clerk of County where business is located; or if no business location in California, with Clerk of Sacramento County.

TO RESERVE A NAME IN OREGON:

Send written request with $50 fee to Corporation Commissioner at address above. If name is available it will be reserved for 120 days.

This can be extended to another 120 days by sending a new letter and another $50 fee.

Sample:
Dear Corp. Commissioner:
This is to request that you reserve the name
Jo-Jo's Donuts
for the corporation JoAnn Smith and Joe Jones
intend to organize. It is to be a donut business.
Enclosed is a check for $50 to reserve the name for
120 days.

ASSUMED BUSINESS NAME FEES

OREGON:

Registration for one year $50

Renewal for two years $50

Amendment - No Fees

Cancellation - $50

WASHINGTON- $15
Register name with:
Master Application
Business License Center
P.O. Box 9048
Olympia, Washington 98507-9048
https://fortress.wa.gov/dol/mls/

CALIFORNIA - There is no provision in California for registration, in a central registry at the state level, of fictitious business names. You must contact the city and/or county clerk recorder where the principal place of business is located for information regarding filing or registering fictitious business names

ARTICLES OF INCORPORATION

Article I - Name of the corporation. (see prior page for restrictions)

Article II- Number of shares the corporation will have authority to issue. There is no limit on number of shares the corporation can issue. Preferably do not ISSUE all of the shares stated as authority to issue.

Article III - Address of registered office and name of registered agent must be stated. A STREET ADDRESS (not Post Office Box) must be given.

Article IV: Address where notices may be sent. This CAN be a Post Office Box and can be different from the registered agent.

Article V: Name and address of EACH incorporator. One person will normally be the incorporator. Each incorporator must sign the Articles.

Article VI: Other provisions. The Articles of Incorporation and the By-Laws will generally control the corporate activities. Generally any other provisions or restrictions are not advisable unless a specific purpose is being served.

FILING THE ARTICLES

OREGON

Two originals must be filed with corporation commissioner along with the required fees.

Filing fee and annual license fees must be paid in first year and sent with the articles of incorporation

When completed, corporation commission will return a certificate of incorporation with one of the original articles attached. This should be filed in the corporate minute book.

WASHINGTON

Duplicate copies, one with original signature. Must be filed with the secretary of state's office along with proper fees .

CALIFORNIA

Original and two copies should be submitted. All will be certified if submitted along with the original to be filed. Certifying more than two copies $8 each. File with secretary of state.

FEES ARE SUBJECT TO CHANGE. YOU SHOULD BE SURE YOU HAVE THE MOST RECENT FEE SCHEDULE.

AFTER YOU HAVE INCORPORATED

✓ Purchase minute book

✓ Purchase a company seal

✓ Purchase share certificates

✓ Open a bank account

- Will require copy of assumed business name
- Will require Federal Employer's I.D. number

✓ Hold a Directors Meeting and at the meeting

- Issue shares
- Elect Officers
- Appoint corporate banker
- Authorize transfer of assets into the corporation
- Make necessary IRS elections (Sub S and 1244)

✓ File the necessary election forms

✓ Adopt by laws

✓ Issue Share Certificates

No longer have to be issued under seal for Oregon

Certificates may be retained in the minute book for safe keeping

Certificates should be numbered consecutively

✓ Obtain leases for property after authorized by resolution of the board of directors. It is important to provide in such leases that, in the event of bankruptcy the property will be returned to lessors.

CORPORATION BY-LAWS

Items that should be covered by laws are as follows. By laws are needed to govern the internal workings of the corporation. These are different from the Articles of Incorporation. The Articles are BASIC only. Since by laws can be changed easier than Articles of Incorporation, it is wise to cover all foreseeable contingencies in the by laws including those covered in Articles.

- Annual meeting of stockholders
  - Time and place
  - Notice requirement
  - Fixing of record date
  - Quorum
  - Order of business

- Special shareholder meeting requirements

- Voting rights and procedures
  - Proxies
  - Cumulative voting

- Shareholder action without meeting

- Directors
  - Qualifications
  - Elections
  - Term of office
  - Replacement
  - Powers
  - Compensation
  - Indemnification
  - Removal

- Directors meetings
  - Regular and special
  - Time and place
  - Notice
  - Quorum

- Action by directors without meeting

- Officers
  - Designation
  - Qualifications
  - Term of office
  - Removal
  - Duties
  - Compensation
  - Indemnification

CORPORATION BY-LAWS

- Committees of the Board
  - Executive
  - Finance
  - Other
- Execution of contracts
- Corporate seal
- Books and records
  - Directors and shareholders rights of inspection
- Stock certificates
  - Issuance
  - Signatures
  - Transfer
- Closing of stock transfer books
- Dividends and reserves
- Fiscal year and audits.

<u>CORPORATE TAX RETURNS</u>

<u>C CORPORATION</u>

- ✓ Must file form 1120 and supporting schedules

- ✓ Due date 15th day of 3rd month after end of tax year.

  <u>THIS MEANS MARCH 15, NOT APRIL 15 FOR CALENDAR YEAR CORPORATION</u>

- ✓ May file 1120A if meet ALL requirements.

  - Gross receipts must be under $500,000
  - Total income must be under $500,000
  - Total assets must be under $500,000
  - Must not have any ownership in foreign corporation
  - Must not have foreign shareholders who own, directly or indirectly, 25% or more of its stock
  - Is not a member of a controlled group
  - Is not a personal holding company
  - Is not a consolidated corporate return filer
  - Is not a corporation undergoing a dissolution or liquidation
  - Is not filing a final tax return
  - Its only dividend INCOME is from domestic corporations and those dividends meet other requirements
  - It has no nonrefundable tax credits other than the general business credit.
  - It is not required to file a special tax return under Special Returns for Certain Organizations
  - It is not subject to environmental tax

<u>IF ALL OF THE ABOVE CONDITIONS ARE NOT MET, THE CORPORATION MUST FILE A FORM 1120 (Not 1120A)</u>

<u>AN ELECTING SUBCHAPTER S CORPORATION MUST FILE FORM 1120S.</u>

STRUCTURE OF A CORPORATION

Board of Directors

Officers

Shareholders

STRUCTURE OF A CORPORATION

Every Corporation has:

- Board of Directors - To watch over the Officers and protect the shareholders, and to decide on important matters that will have a significant effect on the company
- Officers - To carry on the day to day business
- Shareholders - Owners of the Company - Hold the voting power

Final authority (in theory) and power for corporate actions is held by the shareholders.

CAUTION: MINOR SHAREHOLDER'S WITH LESS THAN 50% OF SHARES ARE USUALLY IN A POSITION OF LACKING POWER AND AUTHORITY IN RELATION TO A MAJOR SHARE HOLDER WHO HOLDS MORE THAN 50% OF VOTING POWERS.

IF CORPORATION IS A TWO PERSON CORPORATION AND PARTIES ARE NOT RELATED LEGAL COUNSEL IS ADVISABLE FOR THE MINORITY SHAREHOLDER AT LEAST

OREGON ALLOWS A ONE-PERSON CORPORATION EXISTENCE

SHARES:

Different shares have different restrictions as to dividends, rights to share in assets in event of liquidation etc.

Common Shares - equal shareholder rights in voting, dividends etc.

Preferred-Shareholders have priority over common stockholders

Redeemable cumulative

Voting

It is generally advisable to begin with simply COMMON stock.
Be aware that corporations with other than common stock prior to 7-19-84 were not eligible for Sub-Chapter S elections or Sec 1244 stock elections (discussed later)

Articles of Incorporation must specify number, par value and type of shares the corporation is AUTHORIZED to issue. In order to avoid having to amend the articles of incorporation, more shares should be initially AUTHORIZED than are anticipated to be currently ISSUED.

CORPORATION TAX ADVANTAGES

A CORPORATION ALLOWS FOR DEFERRED COMPENSATION

Deferred compensation (pension plans) are one of the bests forms of tax shelter.

Qualified plans provide employer and employees with tax advantages:

- ✓ Contributions to the plan within limits are deductible by the corporation.
- ✓ Benefits are taxed only upon receipt, presumably when tax brackets are lower at retirement
- ✓ Earnings from the plan are exempt from current taxation
- ✓ Death benefits allow portions of plan funds to be exempt from taxation
- ✓ Contributions to the plan reduce earnings and profits and help avoid accumulated earnings tax
- ✓ Funds contributed to a separate employee benefit plan trust can reduce corporate net worth and thereby reduce value of stock for gift and estate tax purposes

A CORPORATION ALLOWS FOR MEDICAL REIMBURSEMENT PLANS

Allows the corporation to pay medical expenses with tax deductible funds.

Qualified plans should be especially considered for small closely held, family corporations when business is prosperous

Qualified plans may be an alternative to increased salaries for employees and are, therefore, a savings vehicle for reduction of payroll taxes.

CORPORATION TAXATION

A business formed before 1997 and taxed as a corporation under the old rules will generally continue to be taxed as a corporation.

If business formed after 1996 the business will be taxed as a corporation if:

- ✓ A business formed under a federal or state law that refers to it as a corporation, body corporate or body politic.
- ✓ A business formed under a state law that refers to it as a joint-stock company or joint stock association.
- ✓ An insurance company
- ✓ Certain banks
- ✓ A business wholly owned by a state or local government
- ✓ A business specifically required to be taxed as a corporation by the Internal Revenue Code (i.e. certain publicly traded partnerships)
- ✓ Certain foreign businesses
- ✓ Any other business that elects to be taxed as a corporation by filing form 8832

STOCK PURCHASE

EXCHANGE OF PROPERTY FOR STOCK

Transfer of property (or money and property) to a corporation in exchange for stock in that corporation (other than non-qualified preferred stock) and **immediately** afterwards transferor becomes in ***control of the corporation*** **-** transfers usually is **nontaxable.**

Applies to both individuals and to groups who transfer property to a corporation

Applies whether corporation being formed or is already operating.

Does **not** apply if:

The corporation is an investment company

Transfer of the property is in a bankruptcy or similar proceeding in exchange for stock used to pay creditors.

Stock is received in exchange for corporation's debt (other than a security) of for interest on the corporations debt (including a security) that accrued while exchanger held the debt.

Property exchanged for stock does **not** include services rendered or to be rendered to the issuing corporation. **Value of stock received for services is income to the recipient.**

Property (for non taxable exchange rules) does not include property of a relatively small value when it is compared to the value of stock and securities already owned or to be received for services by the transferor, if main purpose of the transfer is to qualify for the non-recognition of gain or loss by other transferors. Not considered of relatively small value if Fair market value is at least 10% of the fair market value of the stock and securities already owned or to be received for services by the transferor.

CONTROL OF A CORPORATION

Must own a least 80% of the total combined **voting power** of ***all*** classes of stock entitled to vote and at least 80% of the outstanding shares of each class of **non voting stock.**

CORPORATE INCOME TAX RETURNS

WHO MUST FILE

Unless exempt organization (section 501), all domestic corporations must file whether or not they have taxable income. (Including bankrupt corporations)

WHAT FORM TO FILE

Form 1120-A: IS OBSOLETE for tax years beginning in 2007. All domestic corporations must file ***Form 1120*** unless they are required to file one of the special returns listed under ‘Special Returns for Certain Corporations.

WHEN TO FILE

By the 15th day of the 3rd month after the end of its tax year.
New corporation filing a short period return - by 15th day of 3rd month after the short period ends
Dissolved corporation - by 15th day of 3rd month after short period ends.

(If due date falls on Saturday, Sunday, or legal holiday, - by next business day)

EXTENSION OF TIME TO FILE

Form 7004 - 6 months extension request.
Needs IRS approval
Must complete form properly, file it, and pay any balance due by due date.

PENALTY FOR LATE FILING

5% of unpaid tax for each month or part of a month late
Maximum of 25% of the unpaid tax.
Reduced by any penalty for late payment of tax for the same period of time
Minimum penalty if over 60 days late is smaller of tax due or $100.

PENALTY FOR LATE PAYMENT OF TAX

1% of the unpaid tax for each month or part of a month tax is not paid
Maximum of 25% of the unpaid tax.

<u>CORPORATE TAXATION-PENALTIES</u>

<u>TRUST FUND RECOVERY PENALTY</u>

For income tax, social security and medicare taxes withheld
If not paid or deposited
<u>**Penalty is the full amount of unpaid trust fund tax**</u>
Applicable if unpaid taxes cannot be immediately collected from the business.

WARNING

Trust fund penalty tax may be imposed on all persons who are determined by the IRS to be responsible for collecting, accounting for, and paying over these taxes, and who acted willfully in not doing so.

**Responsible person can be an officer or an employee an accountant, or a volunteer director/trustee.
May also include one who signs checks for the corporation or otherwise has authority to cause the spending of business funds.**

**Willfully means voluntarily, consciously, and intentionally.
A responsible person acts willfully if the person knows the required actions are not taking place.**

<u>**Signing reports or writing checks for a client may put the tax preparer or accountant in jeopardy of being assessed this 100% penalty!!**</u>

CORPORATE TAX

BASIC FEDERAL RATES

0	+	15% on taxable income to $50,000
$7,500	+	25% on taxable income over $50,000 up to $75,000
$13,750	+	34% on taxable income over $75,000 up to $100,000
$22,250	+	39% on taxable income over $100,000 up to $335,000
$113,900	+	34% on taxable income over $335,000 up to $10,000,000
$3,400,000	+	35% on taxable income over $10,000,000 up to $15,000,000
$5,150,000	+	38% on taxable income over $15,000,000 up to $18,333,333
$6,416,667	+	35% on taxable income over $18,333,334

PERSONAL SERVICE CORPORATIONS

DO NOT BENEFIT FROM GRADUATED RATES.

THEIR INCOME IS TAXED AT A FLAT 35%.

Personal service Corp. is one that is substantially (at least 95%)owned by its employees, retired employees, or their estates
and
whose substantial activities involve the performance of services in the field of health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting.)

CORPORATE TAX

PERSONAL HOLDING COMPANY (PHC)

At least 60% of corporation's adjusted gross income consists of **PHC income and** at any time during last half of tax year, **more than 50%** in value of the corporation's outstanding stock is owned, directly or indirectly by five or fewer individuals.

Exceptions:

- ✓ Tax Exempt corporations
- ✓ Banks
- ✓ Domestic building and loan associations
- ✓ Life insurance companies
- ✓ Surety companies
- ✓ Certain lending or finance companies
- ✓ Certain foreign companies
- ✓ Certain small business investment companies operating under the Small Business Investment Act of 1958
- ✓ Corporations under jurisdiction of the court in a Title 11 or similar case.

PHC INCOME (In general - investment income)

- ✓ Dividends
- ✓ Interest minus certain amounts excluded
- ✓ Royalties minus certain expenses allowed
- ✓ Annuities
- ✓ Rents minus certain expenses allowed
- ✓ Compensation received for use of corporation property from shareholders who own at least 25% of the corporation
- ✓ Amounts received under personal service contract if someone other than the corporation designates the individual who is to perform the services and that performing individual owns at least 25% of corporation
- ✓ Income from estates and trusts

PHC ADJUSTED ORDINARY GROSS INCOME

Corporation's gross income minus:

- ✓ Gains from sale or disposition of capital assets
- ✓ Gains under IRC 1231 (b)
- ✓ Certain foreign corporation income
- ✓ Certain expenses allowed against rental income
- ✓ Certain expenses allowed against royalty income
- ✓ Certain interest income

PHC TAX

Flat 15% tax on undistributed PHC income - in addition to other corporate taxes on income.

CORPORATE TAX

SPECIAL TAXES OR RATES ON CORPORATIONS

ALTERNATIVE MINIMUM TAX

Corporations may also be subject to AMT tax of 20% of its Alternative Minimum taxable income if this is higher than its regular tax liability.

For tax years beginning after 1997, tentative AMT is zero.
For AMT purposes, a corporation qualifies as small corporation if it meets ANY of the following tests:

- ✓ This is its first tax year and "average annual gross receipts" are $5 million or less
- ✓ After the first year of qualification, average gross receipts do not exceed $7.5 million

ENVIRONMENTAL TAX

For tax years beginning before 1996
Tax in addition to any other tax
Not applicable to S corporations
Rate of 0.12% of modified AMT income for the year over $2 million

ACCUMULATED EARNINGS TAX

This is a penalty tax of 15% of subject earnings not distributed for the purpose of avoiding taxable distributions.

Accumulation of $250,000 or less generally as within reasonable needs of most businesses. ($150,000 or less for personal service corporations)

CORPORATE "DOUBLE TAXATION"

CAUTION:

Consideration should be given to comparison of personal income tax rates for small business with one or two owners. Although at first glance it appears that the corporate tax rates are lower than the individual rates, the EFFECTIVE rates are HIGHER for the corporation tax.

Single individual tax rates

Your Taxable Income is: Over	But not over:	Tax is:
$ -0-	- $ 8,350	.........................10%
$8,350	- $ 33,950	$ 835.00 + 15%
$33,950	- $ 82,250	$ 4,675.00 + 25%
$82,250	- $171,550	$ 16,750.00 + 28%
$171,550	-$372,950	$ 41,754.00 + 33%
$372,950 and over		$108,216.00 + 35%

Keep in mind that the personal rates are effective for TAXABLE income after itemized or standard, and personal exemptions.

The Corporate rates are based on PROFIT of the corporation (no std. deduction, itemized, or exemptions).

CORPORATE TAX RESULTS IN INCREASED TAXES

Corporate tax is applied to profits of the corporation.

When the profits are distributed as dividend (to avoid accumulated earnings penalty tax) the dividends are AGAIN taxed to the shareholders.

If shareholders are in top bracket of 35% and Corporation is in top bracket of 35% this means a total of 50.0% tax on the profits of the corporation. (Highest long term capital gain rate) (Plus applicable State Corp tax and individual tax)

If profits are not to be left in the corporation for a business reason, and therefore avoiding the penalty tax, consideration should be given to declaring salaries and bonuses to decrease the corporate income subject to double taxation.

<u>EXAMPLE OF DOUBLE TAXATION</u>

If closely held corporation (husband and wife sole shareholders) generates a net profit of $150,000 after payment of salaries to EACH shareholder, officer, in the amount of $35,000 each (Joint $70,000).

Corporate tax $22,250 + 39% of $50,000	=	<u>$41,750</u> Tax

If the $150,000 is then distributed as dividends to the shareholders, it may qualify as long term capital gain and given that they are in the 15% tax bracket - their long term capital gain tax is 15%.

Shareholder's tax on wages	
$70,000 wages - (Std Ded and Exemptions $18,700)=$51,300	
Taxable $51,300	$ 9,013. Tax
Shareholder's long term capital gain tax	
($150,000 x 15%)	<u>$22,500</u>
Option 1: Total Tax	**$73,263.**

If dividend does not qualify for long term capital gain treatment, the $150,000 distribution would be added to the $70,000 of income resulting in $220,000 of income. Assuming standard deduction for joint under 65 at $11,400 and two exemptions @ $3,650 each, the TAXABLE balance would be $201,300.

Tax on $201,300.	<u>$51,573.</u>
Option 2: Total Tax	**$51,573.**

<u>ALTERNATIVE</u>

<u>If the dividend does not qualify as long term capital gain, declaring additional salary (bonus) in the amount of $150,000 to the two shareholders would be the next best option.</u>

Corporate tax is now -0-
Tax to shareholders is still (generally) $51,573.

<u>Savings of cash results in the amount of $21,690.</u>

NOTE: Since the shareholders have already received a substantial salary, the payroll tax effects are reduced to a minimum.

<u>REMEMBER, OWNERS AND OFFICERS MUST NOT TAKE THIS ACTION UNLESS APPROVED BY THE BOARD OF DIRECTORS. IT MUST BE APPROVED AT A MEETING AND REFLECTED IN CORPORATE MINUTES</u>

ESTIMATED TAX

Generally a corporation must make installment payments of estimated tax if it expects its estimated tax (income tax minus credits) to be $500 or more.

When to pay estimated tax

15th day of the 4th, 6th, 9th, and 12th month of the corporations tax year..

Method #1 - Each required installment 25% of income tax for current year

Method #2 - Each required installment 25% of income tax shown on corporation return for the previous year.

- Must have filed a return for previous year
- Return must have been for a full 12 months
- Return must have shown a positive tax liability (not zero)

If the corporation is a large corporation, may use method #2 only on first installment (Large corporation is one with at least $1 million of modified taxable income in any of the last 3 years. Modified taxable income is taxable income figured without net operating loss carrybacks or carryovers.)

Other methods: (Use Schedule A of form 1120 to compute)

Annualized income installment method
Adjusted seasonal installment method

UNDERPAYMENT PENALTY

Generally must pay if tax liability is $500. or more and did not timely pay the smaller of 2008 tax liability or prior year's tax.
Form 2220- Penalty figured separately for each installment due date
Penalty may apply for one installment even if refund is due when return filed.
Form 2220 not required to be filed - IRS will compute and bill
Form 2220 must be filed if corporation does not owe the penalty.

PAYING ESTIMATES

File form 8109 with authorized financial institution or Federal Reserve Bank unless required to make electronic deposits.

Electronic deposits may be required if total deposits of social security, Medicare, and withheld income taxes were more than $200,000 in prior year. Or in the prior year you were required to file using Electronic Funds Transfer.

STATE TAX RATES FOR CORPORATIONS

CALIFORNIA

Corporations in California must file EITHER:

Franchise tax return

or Income tax return

FRANCHISE TAX:

Imposed on all corporations "doing business"
OR incorporated in California

Prepaid for the PRIVILEGE of doing business

Measured by income of preceding year (income year)
for privilege of doing business in the following
year (taxable year)

Doing business: actively engaging in any transaction
for the purpose of financial gain.

SUBJECT ENTITIES:

All corporations incorporated in California
All corporations doing business in Calif. whether or
not incorporated or qualified under Calif. law.
Banks doing business in California.

MINIMUM FRANCHISE TAX

If subject to the above franchise tax - minimum is $800
Except:
Qualified INACTIVE gold or quicksilver mining corp $25

TAX RATE:

8.84% for all EXCEPT banking corporations or S Corp.

BANKING rate is 10.84% for calendar year banks and
financial corporations that are not S corporations.

STATE TAX RATES FOR CORPORATIONS

CALIFORNIA

CORPORATION INCOME TAX:

Imposed on all corporations that derive income from sources within California but are NOT doing business in California.

INCLUDES:

- Associations
- Massachusetts trusts
- Business trusts
- Real Estate Investment Trusts
- Political organizations that have political TAXABLE income in excess of $100

DOES NOT INCLUDE BANKS

OREGON

Tax Rate 6.6%
Minimum tax is $10
Multnomah County Portland, Oregon rate 1.45%

WASHINGTON

No State tax

STATE TAX RATES FOR CORPORATIONS

OTHER STATE TAXES APPLY IN THE FOLLOWING STATES:
PLEASE BE SURE TO VERIFY CURRENT RATES!

Alabama - 5%
Alaska (graduated rates)- 1% to 9.4%
Arizona (graduated rates)- 8% ($50 minimum)
Arkansas (graduated rates)- 1% to 6% (6.5% of excess over $100,000)
Colorado - 5%
Connecticut 9.5%
Delaware 8.7%
Dist of Columbia -9.975%
Florida 5.5%
Georgia 6% + net worth tax
Hawaii graduated rates 4.4 - 6.4% and separate capital gain 4%
Idaho 8%, Min. $20
Illinois 4.8plus additional 2.5% personal property replacement tax
Indiana 1.2% to 3.0 %
Iowa graduated rates 6% - 12% plus financial institution tax 5%
Kansas 4.% plus 3.25% surtax on taxable income excess of $50,000
Kentucky graduated rates 4% - 8.25% plus license tax
Louisiana graduated rates - 4% to 8%
Maine graduated rates 3.5% to 8.93%
Maryland 7%
Massachusetts5.95% plus surtax 12%
Michigan 2.3%
Minnesota 9.8%
Mississippi graduated rates 3% to 5%
Missouri 6.25% (financial institutions different treatment)
Montana 6.75% with adjustments and surtax Min.$50
except small business corporations minimum is $10
Nebraska graduated rates 5.58% to 7.81%
New Hampshire -Business profits tax 7%
New Jersey 9% plus additional tax on net worth and other adjustments
New Mexico graduated rates 4.8% to 7.6%
New York 3.25% - 3.5% ($100 minimum to $325 minimum)
North Carolina 7.25%
North Dakota Graduated rates 3% to 10.5%.
Ohio graduated rates 5.1% plus 8.5% of excess over $50,000 (net income basis)
Or 4.0 net worth basis (greater of)
Oklahoma 6%
Pennsylvania 7.5% plus
Rhode Island 9% with minimum of $250
So Carolina 5%
Tennessee 6% plus tax on interest and dividends
Utah 5%, Min. $100
Vermont graduated rates 7% to 9.75%
Virginia 6%
West Virginia 9%
Wisconsin 7.9%.

CORPORATE INCOME/DEDUCTIONS

BELOW MARKET LOANS

If a corporation issues a shareholder or an employee a below-market loan, the corporation reports additional income.

Below market loan - provides for no interest or interest at a rate below federal rate that applies.

CAPITAL LOSSES

Deductible up to capital gains. NET capital loss not deductible in current year

Carry NET capital loss back 3 years - **Deduct it from any total net capital gain**

Unused NET capital loss carryforward to future years up to 5 years.

Carryback treated as a short term loss. Does not retain its original identity as long term or short term.

A corporation may NOT carry capital loss from, or to, a year for which it is an S Corporation.

Cannot use a capital loss carried from another year to produce a net operating loss in the year to which carried.

Refund applied for on form 1120X

CORPORATE INCOME/DEDUCTIONS

CHARITABLE CONTRIBUTIONS

Limited deduction

Deductible if to or for the use of a qualified organization.

No deduction if any of the net earnings of an organization **receiving** contributions benefit any private shareholder or individual.

Publication 78 -Cumulative list of Organizations lists most qualified organizations. (IRS Home Page at www.irs.ustreas.gov/prod/bus_info/eo/eosearch.html)

Accrual method corporation - can deduct in year board of directors authorizes the contribution IF it pays them within 2 ½ months after close of tax year.
- Report contributions on return for that tax year
- Attach copy of resolution authorizing and declaration adoption to return signed by an officer authorized to sign

Limit on contributions deduction

Can not deduct as charitable contributions for a tax year more than 10% Of taxable income.

Taxable income (for this purpose) without deductions for:
- Charitable contributions
- Deductions for dividends received and dividends paid
- Any net operating loss carryback to the tax year
- Any capital loss carryback to the tax year

Carryover of excess contributions

- To each of the following 5 years
- Current year contributions deducted first, then carryovers
- Can not deduct to extent it increases a net operating loss carryover

CORPORATE INCOME/DEDUCTIONS

CORPORATE PREFERENCE ITEMS

Corporation adjusts following items before it takes them into account in determining taxable income:

✓ **Section 1250 capital gains**
20% of any excess of:
a) amount that would be ordinary income if the property was section 1245 property
over b) amount treated as ordinary income under section 1250
Must be recognized under section 1250.

✓ **Percentage depletion - iron ore and coal**
Reduce allowable percentage depletion deduction by 20% of any excess of:
a) percentage depletion deduction allowable for the tax year (without this adjustment)
over b) Adjusted basis of the depletable property at close of the year (figured without depletion deduction for the current tax year)

✓ **Pollution control facilities**
Reduce amortizable basis of facilities by 20% in determining the amortization deduction for that property.

✓ **Mineral exploration and development costs and intangible drilling costs.**
Reduce allowable deduction by 30%.

These adjustments apply to all corporations. Do NOT apply to an S Corporation unless it or a predecessor was a C corporation for any of the 3 immediately preceding years.

CORPORATE INCOME/DEDUCTIONS

DIVIDENDS RECEIVED DEDUCTION

A corporation can deduct a percentage of certain dividends received during tax year.

Domestic corporation dividends
Deduct 70% of the dividends received if corporation receiving the dividend owns less than 20% of distributing corporation
20% or more owners allowed 80% deduction

Dividends on debt financed portfolio stock require reduced %

Small business investment companies can deduct 100% of dividends received from a taxable domestic corporation

Affiliated corporations can deduct 100% of dividends from a member of the same affiliated group if they meet certain conditions

Dividends from regulated investment company - subject to limits. Capital gain dividends do not qualify for the deduction.

Dividends on preferred stock of public utilities -deduction 42% of a less than 20% owned taxable public utility. 48% if 20% or more owned.

Dividends from Federal Home Loan Banks qualify for deduction

Dividends from foreign corporations - a percentage received from 10% owned foreign corporation is deductible

NO deduction allowed for dividends received from:

- A real estate investment trust
- Corporation exempt from tax for the year or distribution or preceding year
- Corporation whose stock has been held than 46 days during 90 day period beginning 45 days before stock becomes ex-dividend with respect to the dividend
- Corporation whose preferred stock has been held less than 91 days during the 180 day period beginning 90 days before stock becomes ex-dividend with respect to the dividend if the dividends received on it are for a period or periods totaling more than 366 days.
- Any corporation if under obligation to make related payments for position in substantially similar or related property

No deduction for dividends on deposits in domestic building and loan associations mutual savings banks, cooperative banks, and similar organizations. These are INTEREST.

CORPORATE INCOME/DEDUCTIONS

DIVIDENDS RECEIVED DEDUCTION

Limit on deduction for dividends

Total deduction limited (in the following order)

1) 80% of the difference between taxable income and the 100% deduction allowed for dividends received from affiliated corporations or by a small business investment company, for dividends received or accrued from a 20% owned corporation

And 2) 70% of the difference between taxable income and the 100% deduction allowed for dividends received from affiliated corporations or by a small business investment company for dividends received or accrued from less than 20% owned corporations (reducing taxable income by the total dividends received rom 20% owned corporations.

Taxable income for figuring limit, without:

- Net operating loss deduction
- Deduction for dividends received
- Adjustment due to the part of an extraordinary dividend that is not taxable
- Deduction for contributions to Capital construction fund
- Any capital loss carryback to the tax year.

If corporation has net operating loss for a tax year, the limit of 80% (or 70%) does not apply. (Determine NOL without 80% (or 70% dividends received deduction)

Extraordinary Dividends

If corporation receives extraordinary dividend on stock held 2 years or less before dividend announcement date, generally must reduce basis in the stock by the non-taxed part of the dividend.

Extraordinary dividend -dividend that equals or exceeds a certain percentage of corporation’s adjusted basis in the stock.

Disqualified preferred stock treated as an extraordinary dividend regardless of period the corporation held the stock

GOING INTO BUSINESS COSTS

BUSINESS START UP COSTS

Costs for setting up active trade or business

Costs for investigating the possibility of creating or acquiring an active trade/business

Include amounts paid or incurred in connection with any activity engaged in for profit and for the production of income before the trade or business begins, in anticipation of the activity becoming an active trade or business.

To be amortizable

Must be a cost that could be deducted if paid or incurred to operate
an existing active trade or business
AND
Must pay or incur the cost before the day active trade or business begins.

May include

- Survey of potential markets
- Analysis of available facilities, labor, supplies
- Advertisements for opening
- Salaries and wages for employees who are being trained, and instructors
- Travel and other necessary costs for securing prospective distributors, Suppliers, or customers.
- Salaries and fees for executives and consultants, or for professional Services.

Do not include

- Deductible interest, taxes, and research and experimental costs.

Disposition of business

May deduct any remaining deferred start up costs for business if completely dispose of business before end of the amortization period - but only to extent they qualify as a loss from a business.

GOING INTO BUSINESS COSTS

ORGANIZATIONAL COSTS

Qualifying costs must meet all three of following tests:

- ✓ Must be for creation of the corporation
- ✓ Must be chargeable to capital account
- ✓ Could amortize cost over life of corporation, if corporation had a fixed life.

Must have been incurred before end of first tax year.

Cash method corporation can amortize organizational expenses incurred in the first year, even if it does not pay them in that year.

Examples of organizational costs

- ✓ Expenses of temporary directors
- ✓ Cost of organizational meetings
- ✓ State incorporation fee
- ✓ Accounting services for setting up the corporation.
- ✓ Legal services for organizational

NOT amortizable:

- ✓ Costs for issuing and selling stock or securities
- ✓ Costs associated with transfer of assets

AMORTIZATION OF START UP AND ORGANIZATIONAL COSTS

Over a period of 60 months or more
Can elect a different period for start up costs than for organizational costs
    as long as both are 60 months or more.
Irrevocable election of period
Begins with month you begin business operations
Election on part VI of form 4562 and attached to tax return
Attach statement to return for each type of cost with following information
    Total start up or organizational costs to be amortized
    What each cost is for
    Date each cost incurred
    Month active business began
    Number of months in amortization period (not less than 60)
Only amortizable by the corporation - not by a shareholder
    If corporation reimburses shareholder - corporation may then amortize
    If no reimbursement - costs become part of shareholders basis (outside)
        and are only recovered when interest in corporation is sold.

RELATED PARTY RULES

RELATED PERSONS

- ✓ An individual and a corporation the individual controls
- ✓ Two corporations that are members of same controlled group
- ✓ A partnership and a corporation controlled by same person
- ✓ An S corporation and a C corporation controlled by same persons.

Rules deny deduction of losses on sale or exchange of property between related persons

Rules deny deduction of certain unpaid business expenses and interest on transactions between related persons.

Losses on sale or exchange of property between members of the same controlled group of corporations is deferred rather than denied.

An accrual basis corporation can not deduct expenses owed to a related cash basis person until payment is made and the amount is included in income of person paid.

Liquidations - Disallowance of losses from sale or exchange or property between related persons does not apply to liquidating distributions.

Interest paid to related persons may be limited if paid (or accrued) to related persons not subject to tax on the interest received if corporation has excess interest expense and a debt ratio greater than 1.5 to 1 at end of year.

Not subject to tax: related person is not subject to U.S. income tax on the income.
Excess interest expense - excess of corporations net interest expense over the sum of 50% of adjusted taxable income plus any excess limit carryforward.

AT RISK LIMITS

At risk limits limit losses from most activities to the amount at risk in the activity.
At risk rules apply to certain closely held corporations (other than S corporations.

Closely held corporation: (for at risk rules)

If, at any time during the last half of the year, more than 50% in value of outstanding stock owned directly or indirectly by or for five fewer individuals.

PASSIVE ACTIVITY LIMITS

Passive activity rules apply to personal service corporations and closely held corporations.

CREDITS AGAINST CORPORATE TAX LIABILITY

- Credit for federal tax on fuels used for certain purposes
- Credit for prior year minimum tax (form 8827)
- Foreign tax credit (Form 1118)
- Nonconventional source fuel credit
- Possessions tax credit (form 5735)
- Qualified electric vehicles credit (form 8834)
- General Business credit: (Form 3800)
  - Alcohol used as fuel credit (form 6478
  - Community Development Corporations (Form 8847)
  - Disabled access credit (form 8826)
  - Employer social security certain employee tips (Form 8846)
  - Empowerment zone employment credit (Form 8844)
  - Employer Provided Child Care Credit (Form 8882)
  - Enhanced oil recovery credit (Form 8830)
  - Indian employment credit (Form 8845)
  - Investment credit (Form 3468)
  - Low income housing credit (Form 8586)
  - New Markets Tax Credit (Form 8874)
  - New York Liberty Zone Business Employee Credit (Form 8884)
  - Orphan drug credit (Form 8820)
  - Renewable electricity production credit (Form 8835)
  - Research credit (Form 6765)
  - Small Employer Pension Start-Up Costs (Form 8881)
  - Welfare to work credit (Form 8861)
  - Work opportunity credit (Form 5884)

Must file form 3800 (in addition to the credit form) if any of the following apply:

- Have more than one of above credits (other than empowerment zone credit)
- Have carryback or carryforward of any of the credits (other than the empowerment zone credit)
- Any of these credits (other than low income housing and empowerment zone) is from a passive activity.

RECAPTURE TAXES

CREDITS THAT A CORPORATION MAY NEED TO RECAPTURE

- Indian employment credit
- Investment credit
- Low income housing credit
- Qualified electric vehicles credit.

RECONCILIATION STATEMENTS

Must be completed if total assets are at least $250,000

SCHEDULE M-1

Starts with net income (loss) per books
Provides for necessary adjustments to reconcile this amount with taxable income shown on form 1120 (corporate tax return)

SCHEDULE M-2

Analyzes the unappropriated retained earnings as shown in corporations balance sheet

SCHEDULE M-3

Net Income(Loss) Reconciliation for Corporations With Total Assets of $10 Million or More.

Schedule M-3 is effective for any tax year ending on or after December 31, 2004.
Any domestic corporation that is required to file Form 1120 and reports on Schedule L, Balance Sheet per Books (Form 1120), total consolidated assets at the end of the corporation's tax year that equal or exceed $10 million must complete and file Schedule M-3 in place of Schedule M-1, Reconciliation of Income(Loss) per Books With Income per Return. This requirement applies to a U.S. consolidated tax group consisting of a U.S. parent corporation and additional includible corporations listed on Form 851, *Affiliations Schedule*.

A corporation required to file Schedule M-3 must complete the form in its entirety.

See the instructions to the Schedule M-3 for more information including effects on Schedule L.

EARNINGS AND PROFITS

Taxable distributions come first from current earnings and profits and then from accumulated earnings and profits.

To the extent that distributions are more than both current and accumulated earnings and profits, the distributions may be partly or completely non taxable. (File form 5452)

Retained earnings will generally differ from accumulated earnings and profits because of differences in computing book and tax earnings.

Use taxable income (before special deductions) as starting point for figuring current year earnings and profits.

Taxes accrued for book income may differ from amount of actual federal income tax liability. In this case, earnings and profits reflect only the latter.

Capital losses are allowable in the year incurred but must be added back in the year they are applied against gains to prevent double taxation.

Excess contributions are allowable in the year made and added back in year deducted.

Since only the premium in excess of cash surrender value represents an expense to the corporation, only that amount reduces earnings and profits.

Nondeductible interest expenses reduce earnings and profits.

Nondeductible contributions reduce earnings and profits.

Add tax exempt interest income to earnings and profits

Add insurance proceeds in excess of cash surrender value to earnings and profits

Add recovery of a debt written off on the books but not deducted on tax return.

Depreciation claimed on the tax return over the straight line amount increases earnings/profits

> (For tangible property depreciated under MACRS the adjustment to earnings and profits for depreciation is the amount figured using alternative depreciation system (ADS) of MACRS. If section 179 deduction, E&P only can deduct the section 179 amount that is figured ratably over a 5 year period)

Distributions that are more than current year earnings and profits reduce accumulated earnings and profits.

Distributions that are more than earnings and profits and that represent dividends that are not taxable to shareholders reduce the corporations capital.

DISTRIBUTIONS FROM CORPORATION

Any distribution to shareholders from earnings and profits is generally a **dividend.**

A distribution is not a taxable dividend if it is a return of capital to shareholder.

Distributions may be in money, stock, or other property.

Form 1099-DIV must be filed for each shareholder to whom a corporation pays gross dividends of $10 or more during a calendar year. Form 1096 is filed to summarize and transmit 1099-DIV forms. **File form 5452 if corporation pays dividends that are not taxable.**

Backup withholding may be required. 30% of dividends paid. Not required if dividend is less than $10.

Amount of distribution - money paid plus fair market value on distribution date of other property transferred to shareholder.

Reduced (but not below zero) by liabilities assumed by shareholder and liabilities to which the property is subject.

Basis of property received by shareholder is FMV

Cancellation of shareholder's debt without repayment is a distribution.

Distributions of Appreciated Property

Distributing corporation generally does not recognize gain or loss (if not in complete liquidation)

If distribution of property, other than its own obligations, to a shareholder and FMV exceeds corporations adjusted basis, treated as sold at the time of the distribution. Corporation recognizes gain on the excess of FMV over adjusted basis.

Distributions of Depreciation Property

If FMV of depreciated property distributed to shareholders is more than adjusted basis of property, corporation must report ordinary income because of the depreciation recapture. This applies even though the distribution, either as a dividend or in liquidation, might otherwise be non-taxable.

Taxable Status of Distributions

The part of distribution from earnings and profits is a dividend

The part of the distribution that is more than E & P reduces adjusted basis of the stock in the hands of the shareholder (return of capital)

Amount that exceeds adjusted basis of stock is treated as gain from sale/exchange

DISTRIBUTIONS FROM CORPORATION

Distributions of Stock and Stock Rights

Shareholder does not include in gross income unless it is one of following:

- A distribution instead of money or other property
- A disproportionate distribution
- A distribution on preferred stock
- A distribution of convertible preferred stock, unless corporation can establish to IRS satisfaction that it will not result in a disproportionate distribution
- A distribution of common and preferred stock resulting in The receipt of preferred stock by some common shareholders and receipt of common stock by other common shareholders.

Even if one of the above applies, there must be sufficient earnings and profits for the distribution to be a dividend.