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Permtemp Corporation formed in 2014 and, for that year, reported the following book income statement and balance sheet, excluding the federal income tax expense, deferred tax assets, and deferred tax liabilities:

Sales		\$20,000,000
Cost of goods sold		<u>(15,000,000)</u>
Gross profit		\$ 5,000,000
Dividend income		50,000
Tax-exempt interest income		<u>15,000</u>
Total income		\$ 5,065,000
Expenses:		
Depreciation	\$ 800,000	
Bad debts	400,000	
Charitable contributions	100,000	
Interest	475,000	
Meals and entertainment	45,000	
Other	<u>3,855,000</u>	
Total expenses		<u>(5,675,000)</u>
Net loss before federal income taxes		<u>\$ (610,000)</u>
Cash		\$ 500,000
Accounts receivable	\$ 2,000,000	
Allowance for doubtful accounts	<u>(250,000)</u>	1,750,000
Inventory		4,000,000
Fixed assets	\$10,000,000	
Accumulated depreciation	<u>(800,000)</u>	9,200,000
Investment in corporate stock		1,000,000
Investment in tax-exempt bonds		<u>50,000</u>
Total assets		<u>\$16,500,000</u>
Accounts payable		\$2,610,000
Long-term debt		8,500,000
Common stock		6,000,000
Retained earnings		<u>(610,000)</u>
Total liabilities and equity		<u>\$16,500,000</u>

Additional information for 2014:

- The investment in corporate stock is comprised of less-than-20%-owned corporations.
- Depreciation for tax purposes is \$1.4 million under MACRS.
- Bad debt expense for tax purposes is \$150,000 under the direct writeoff method.
- Limitations to charitable contribution deductions and meals and entertainment expenses must be tested and applied if necessary.
- Qualified production activities income is zero.

Required for 2014:

- a. Prepare page 1 of the 2014 Form 1120, computing the corporation's NOL.
- b. Determine the corporation's deferred tax asset and deferred tax liability situation, and then complete the income statement and balance sheet to reflect proper GAAP accounting under ASC 740. Use the balance sheet information to prepare Schedule L of the 2014 Form 1120.
- c. Prepare the 2014 Schedule M-3 for Form 1120.
- d. Prepare a schedule that reconciles the corporation's effective tax rate to the statutory 34% tax rate.

Note: For 2014 forms, go to forms and publications, prior year, at the IRS website, www.irs.gov.

The Corporate Income Tax

For 2015, Permtemp reported the following book income statement and balance sheet, excluding the federal income tax expense, deferred tax assets, and deferred tax liabilities:

		\$33,000,000
Sales		<u>(22,000,000)</u>
Cost of goods sold		\$11,000,000
Gross profit		55,000
Dividend income		<u>15,000</u>
Tax-exempt interest income		\$11,070,000
Total income		
Expenses:		
Depreciation	\$ 800,000	
Bad debts	625,000	
Charitable contributions	40,000	
Interest	455,000	
Meals and entertainment	60,000	
Other	<u>4,675,000</u>	
Total expenses		<u>(6,655,000)</u>
Net income before federal income taxes		<u>\$ 4,415,000</u>
		\$ 2,125,000
Cash		
Accounts receivable	\$ 3,300,000	
Allowance for doubtful accounts	<u>(450,000)</u>	2,850,000
Inventory		6,000,000
Fixed assets	\$10,000,000	
Accumulated depreciation	<u>(1,600,000)</u>	8,400,000
Investment in corporate stock		1,000,000
Investment in tax-exempt bonds		<u>50,000</u>
Total assets		<u>\$20,425,000</u>
		\$ 2,120,000
Accounts payable		8,500,000
Long-term debt		6,000,000
Common stock		<u>3,805,000</u>
Retained earnings		<u>\$20,425,000</u>

Additional information for 2015:

- Depreciation for tax purposes is \$2.45 million under MACRS.
- Bad debt expense for tax purposes is \$425,000 under the direct writeoff method.
- Qualified production activities income is \$3 million.

Required for 2015:

- a. Prepare page 1 of the 2015 Form 1120, computing the corporation's taxable income and tax liability.
- b. Determine the corporation's deferred tax asset and deferred tax liability situation, and then complete the income statement and balance sheet to reflect proper GAAP accounting ASC 740. Use the balance sheet information to prepare Schedule L of the 2015 Form 1120.
- c. Prepare the 2015 Schedule M-3 for Form 1120.
- d. Prepare a schedule that reconciles the corporation's effective tax rate to the statutory 34% tax rate.

CASE STUDY PROBLEMS

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Marquette Corporation, a tax client since its creation three years ago, has requested that you prepare a memorandum explaining its estimated tax requirements for the current year. The corporation is in the fabricated steel business. Its earnings have been growing each year. Marquette's taxable income for the last three tax years has been \$500,000, \$1.5 million, and \$2.5 million, respectively. The Chief Financial Officer expects its taxable income in the current year to be approximately \$3 million.

Required: Prepare a one-page client memorandum explaining Marquette's estimated tax requirements for the current year, providing the necessary supporting authorities.