Solutions for Pearsons Federal Taxation 2022 Comprehensive 35th Edition by Rupert

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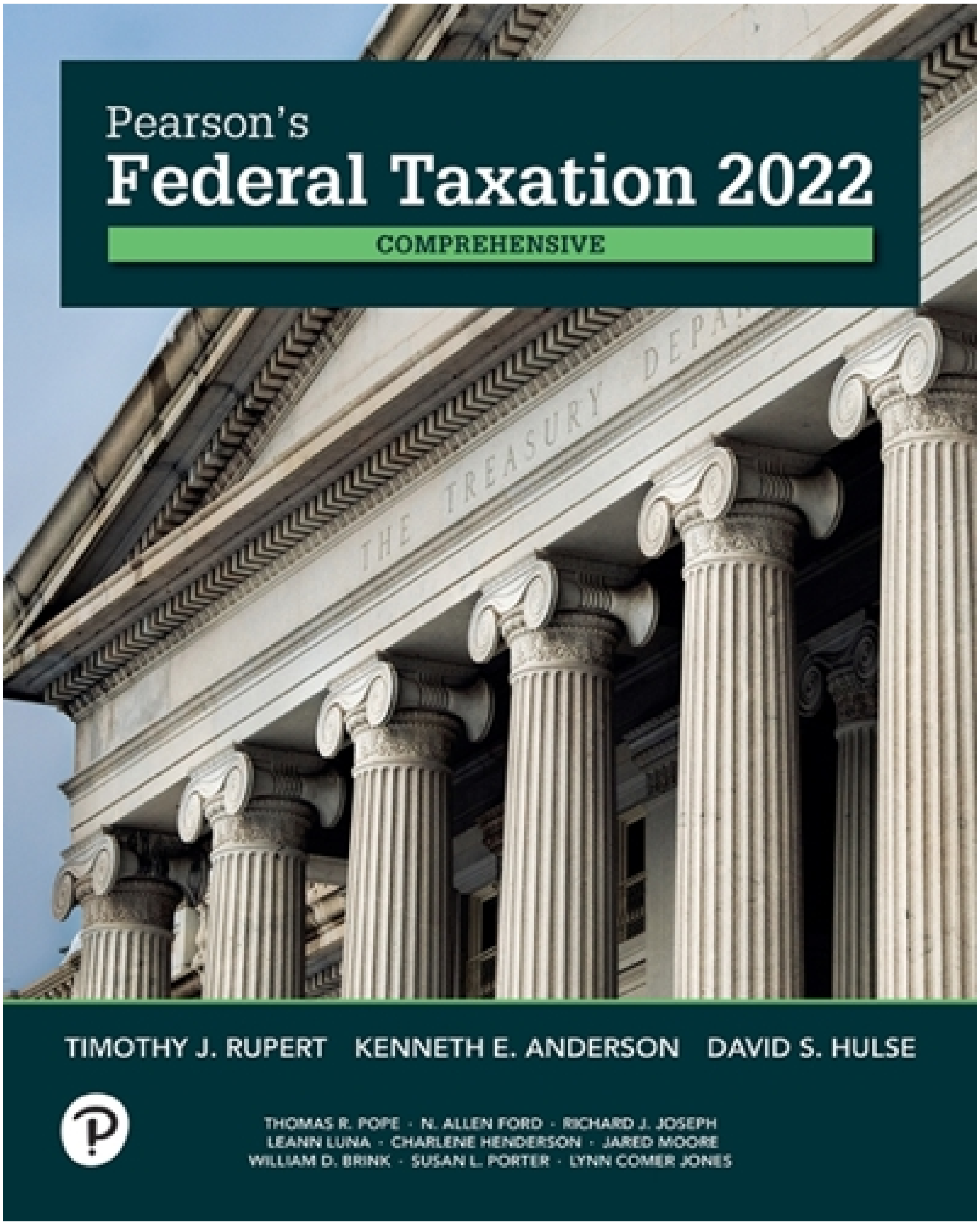


Solutions

Chapter I:1

An Introduction to Taxation

Discussion Questions

I:1-1 The Supreme Court held the income tax to be unconstitutional in 1895 because the income tax was considered to be a direct tax. At that time, the U.S. Constitution required that an income tax be apportioned among the states in proportion to their populations. This type of tax system would be extremely difficult to administer because different rates of tax would apply to individual taxpayers depending on their states of residence. p. I:1-2.

I:1-2 The pay-as-you-go withholding was needed in 1943 to avoid significant tax collection problems as the tax base broadened from 6% of the population in 1939 to 74% in 1945. Pay-as-you-go permitted the federal government to deduct taxes directly out of an employee's wages. p. I:1-3.

I:1-3 Under a progressive tax rate structure, the tax rate increases as the taxpayer's income increases. Currently, for 2021, tax rates of 10%, 12%, 22%, 24%, 32%, 35% or 37% apply depending upon the taxpayer's filing status and taxable income levels. Under a proportional tax rate or "flat tax" structure, the same tax rate applies to all taxpayers regardless of their income levels. Under a regressive tax rate structure, the tax rate decreases with an increase in income level. The concept of vertical equity holds that taxpayers with higher income levels should pay a higher proportion of tax and that the tax should be borne by those who have the "ability to pay." Thus, Congressman Patrick's opposition to the flat tax is philosophically correct; under a flat tax system, all taxpayers pay taxes at the same rate, regardless of the ability to pay. pp. I:1-4 and I:1-5.

I:1-4 It is possible for the government to raise taxes without raising tax rates. Because there are two components in computing a taxpayer's tax, the tax base and the tax rate, taxes can be raised by increasing either the rate or the base. Thus, even though the Governor proclaimed that tax rates have remained at the same level, adjustments to the tax base, such as the elimination of deductions, result in tax increases which can be as much, or more, as increases in tax rates. p. I:1-4.

I:1-5 The marginal tax rate is of greater significance in measuring the tax effect for Carmen's decision. The marginal tax rate is the percentage that is applied to an incremental amount of taxable income that is added to or subtracted from the tax base. Through the marginal tax rate, the taxpayer may measure the tax effect of the charitable contribution to her church. If her marginal tax rate is 24%, she will save 24¢ for each $1 contributed to her church. The average tax rate is simply the total tax liability divided by taxable income. pp. I:1-5 and I:1-6.

I:1-6 Gift and estate taxes are levied when a transfer of wealth (property) takes place and are both part of the unified transfer tax system. The tax base for computing the gift tax is the fair market value of all gifts made in the current year minus an annual donee exclusion of $15,000 (2021) per donee, minus a marital deduction for gifts to spouse and a charitable contributions deduction if applicable, plus the value of all taxable gifts in prior years. The tax base for the estate tax is the decedent's gross estate, minus deductions for expenses, and a marital or charitable deduction if applicable, plus taxable gifts made after 1976. pp. I:1-7 through I:1-10.

I:1-7 a. Cathy, the donor, is primarily liable for the gift tax on the two gifts. The children are contingently liable for payment of the gift tax in the event the donor fails to pay.

b. Before considering the unified tax credit equivalent of $11.7 million for 2021, a gift tax results on the two gifts for the current year 2021 computed as follows:

Total gifts	$100,000
Minus: Annual gift tax exclusion ($15,000 x 2 donees)	(30,000)
Gift tax base	$ 70,000

Since Cathy has never made gifts in prior years, no gift tax will be due because of the substantial unified tax credit that is available. pp. I:1-8 and I:1-9.

I:1-8 Carlos would report a taxable gain of $2,000 ($27,000 - $25,000). His tax basis in the stock that he inherited is the fair market value on the date of his father's death. pp. I:1-9 and I:1-10.

I:1-9 a. Most estates are **not** subject to the federal estate tax because of generous credit and deduction provisions, such as the unified tax credit and the unlimited marital deduction. The unified tax credit equivalent for 2021 is $11.7 million. This means that, at a minimum, for decedents dying in 2021, no estate of $11.7 million or less will be subject to the federal estate tax.

b. This is a controversial question that has proponents on both sides of the issue. Those that believe the estate tax should be reduced or eliminated basically argue that the estate tax is a double tax, that is, the property of the decedent has already been subject to income taxation during his or her lifetime and should not be subjected to further taxation at death. On the other hand, proponents of retaining or increasing the estate tax believe in the ability to pay principle. p. I:1-10.

I:1-10 a. Progressive.
b. Progressive.
c. Proportional.
d. Proportional.
e. Proportional. (However, state and local sales taxes are considered regressive when measured against income).
pp. I:1-4 and I:1-5 and I:1-12.

I:1-11 Decrease. When Carolyn operates her business as a sole proprietor, she is considered to be self-employed. A self-employment tax is imposed at the rate of 15.3% for 2021 (12.4% OASDI + 2.9% Medicare) on all of her business income with a ceiling on the non-hospital insurance (OASDI) portion of the tax base of $142,800 in 2021. Carolyn is also entitled to an income tax deduction equal to 50% of the self-employment tax payments if she is self-employed. If she works as an employee, however, the OASDI and Medicare taxes are imposed at the employee level at a rate of 7.65% for 2021. The OASDI is imposed on earned income up to a maximum of $142,800 in 2021 while Medicare taxes have no ceiling. Her employer would have to match Carolyn's OASDI and Medicare taxes. Thus, Social Security taxes are levied at the same rate of 15.3% (7.65% on the employee and 7.65% on the employer). If the corporation does not pay Carolyn a salary equal to its earnings, the Social Security taxes will be slightly less than under the sole proprietorship. The hospital insurance portion of the FICA premium continues to apply with no ceiling amount for employees, employers, and self-employed individuals. The rate is 2.9% for self-employed individuals and 1.45% each for employees and employers. p. I:1-11.

I:1-12 a. Property taxes are primarily used by local governments and include both real property taxes (real estate) and personal property taxes (tangible and intangible property).

b. Excise taxes are primarily used by the federal government and are imposed on items such as alcohol, tobacco, telephone usage, and many other goods. While not as extensive as the federal government, many state and local governments impose similar types of taxes.

c. Sales taxes are primarily used by state governments and constitute a major revenue source for many states. Local governments are increasingly using sales taxes as well as states. The local governments frequently tack-on 1¢ or 2¢ to the existing state sales tax rather than imposing a separate sales tax.

d. Income taxes are the primary domain of the federal government and constitutes its major source of revenue. However, many state and local governments now use the income tax in their revenue structures.

e. Employment taxes are primarily used by the federal government. Social security (FICA) taxes are a major source of federal revenue. Unemployment taxes are used by states as a compliment to the federal unemployment compensation tax. pp. I:1-10 and I:1-11.

I:1-13 a. The five characteristics of a "good" tax are equity, certainty, convenience, economy, and simplicity. Equity refers to the fairness of the tax to the taxpayers. A certain tax is one that ensures a stable source of government revenue and provides taxpayers with some degree of certainty concerning the amount of their annual tax liability. Convenience refers to the case of assessment, collectability, and administration for the government and reasonable compliance requirements for taxpayers. An economical tax requires minimal compliance costs for taxpayers and minimal administration costs for the government. Simplicity means the tax system is simple to understand and to comply.

b. 1. The federal income tax meets the first four criteria reasonably well, even though many critics would suggest otherwise. The tax is reasonably fair in that the high-income taxpayers pay the most tax, the low-income taxpayers the least tax. While tax laws are constantly changing, most taxpayers have a pretty good idea of what their taxes are going to be for the tax year and the federal income tax does provide the government with a stable source of revenue. The tax is convenient to pay although compliance requirements for taxpayers have risen steadily over the years. The tax is economical for the government to collect; however, the cost of compliance for taxpayers is much too high as approximately 56% of all taxpayers pay a tax preparer to prepare their tax returns. However, virtually no one would suggest that the federal income tax law is simple. In fact, complexity is one of the law’s major flaws.

2. The state sales tax meets the criteria of certainty, convenience, economy and simplicity quite well. However, the sales tax is criticized as not being equitable as it tends to fall more heavily on lower and middle-income taxpayers.

3. Property taxes do not fare well according to the characteristics of a "good" tax. From equity standpoint, the property tax is imposed on property owners without regard to their income situation. Thus, a farmer may have substantial property but little income to pay the property tax. Property taxes are certain but clearly not convenient in the sense that they are normally assessed in a lump-sum amount once a year. Property taxes do not meet the economy criteria. Property taxes are rather simple although differences in judgments as to valuation of property are a problem. pp. I:1-12 through I:1-14.

I:1-14 a. Horizontal equity refers to the concept that similarly situated taxpayers should pay approximately the same amount of tax. Vertical equity, on the other hand, refers to the concept that higher income taxpayers should not only pay a higher amount of tax but should pay a higher percentage of tax. Vertical equity is based on the notion that taxpayers who have the "ability to pay" (e.g., higher income taxpayers) should pay more tax than lower income taxpayers.

b. Fairness is an elusive term. Because of widely divergent opinions as to what constitutes fairness, it logically follows that there are also many different and divergent opinions as to what constitutes a "fair" tax structure. p. I:1-13.

I:1-15 Secondary objectives include the following:

a. Economic objectives such as stimulating private investment, reducing unemployment, and mitigating the effects of inflation.

b. Encouraging certain activities such as research and development and small business investment.

c. Social and public policy objectives, (e.g. encouraging charitable contributions and discouraging illegal bribes). pp. I:1-14 and I:1-15.

I:1-16 Probably not. It would be difficult to achieve a simplified tax system and also provide incentives to certain industries as well as achieve social objectives. To achieve a simplified tax system would require the elimination of special purpose provisions, such as with the several consumption tax proposals being forwarded. But consumption taxes generally are considered unfair as they fall disproportionately on the low and middle class. pp. I:1-14 through I:1-16.

I:l-17 Taxpaying entities generally are required to pay income taxes on their taxable income. The major taxpaying entities are individuals and C corporations. Flow-through entities generally do not directly pay income taxes on their taxable income but merely pass the income on to a taxpaying entity. The major flow-through entities are sole proprietorships, partnerships, S corporations, limited liability companies (LLC), limited liability partnerships (LLP), and certain trusts. Some entities do not neatly fall within each category and are actually hybrid entities. S corporations, for example, are subject to income taxes in certain situations, such as taxes on built-in gains, the LIFO recapture tax, etc. Not many S corporations incur these taxes. pp. I:1-16 through I:1-24.

I:1-18 Sally and Tom’s taxable income for 2021 would be $64,900, computed as follows:

AGI	$ 90,000
Larger of itemized deductions ($10,000) or standard deduction ($25,100)	(25,100)
Taxable income	$ 64,900

As can be seen above, the standard deduction of $25,100 is larger than their itemized deductions, so they obviously would claim the standard deduction. Alternatively, if the itemized deductions were $28,000, their taxable income would be $62,000 ($90,000 - $28,000) as the itemized deductions exceed the standard deduction of $25,100. Taxpayers are allowed to deduct the greater of itemized deductions or the standard deduction. pp. I:1-6, I:1-7, and I:1-17.

I:1-19 To properly respond to Bruin, tax calculations for both Bruin Corporation and John Bean must be made for the year.

$400,000 dividend. If the $400,000 is distributed to John as a dividend, Bruin Corporation would get no deduction for the dividend and would have corporate taxes of $105,000 ($500,000 x 0.21) based on taxable income of $500,000. John would then pay a maximum rate of 20% on the dividend because his taxable income is greater than $445,850 given the tax bracket he is in, so the income taxes due by John on the $400,000 dividend would be $80,000. Thus, the total income taxes would be $185,000 ($105,000 + $80,000).

$400,000 salary. If the $400,000 is distributed to John as a salary, Bruin Corporation would be allowed a deduction and the corporation's taxable income now would be $100,000. The corporate tax on $100,000 is $21,000. John would be required to pay income taxes on the $400,000 at 37%, so the tax would be $148,000. The total income taxes for the year would be $169,000.

As can be seen from the analysis above, the $400,000 salary would result in smaller taxes. This results even though John is in the top 37% tax bracket. The tax savings would be even higher if John were in a lower tax bracket. (Note that this solution ignores the incremental 3.8% tax on net investment income for high income taxpayers, which is discussed in later chapters). pp. I:1-19 and I:1-20.

I:1-20 The term "double taxation" refers to the taxing of the same income twice. This type of taxation typically results from a C corporation paying tax on its taxable income and shareholders paying income tax on any dividends received from the C corporation. The impact of double taxation of C corporations has been substantially reduced by the fact that dividends are taxed at a maximum rate of 20%. An example of double taxation can be seen in Example I:1-15 of the textbook. pp. I:1-19 and I:1-20.

I:1-21 Limited liability companies (LLCs) generally are taxed as partnerships. Therefore, the LLC is not subject to income tax on its taxable income but such income is allocated to the members (owners) of the LLC. Thus, only a single-level of taxation is imposed. The same allocation rules that pertain to partnerships also apply to LLCs. Another principle feature of LLCs is limited liability for owners (members) of the LLC. pp. I:1-22 and I:1-23.

I:1-22 To prevent double taxation, the tax law allows partners to increase their basis in the partnership for any income that is allocated to the partner. Since partnership distributions are not subject to taxation if such distributions are less than the partner's basis, double taxation is prevented. Similarly, to prevent double deductions, the tax law requires partners to decrease their basis for any loss or deduction that is allocated to the partner. pp. I:1-21 and I:1-22.

I:1-23 Schedule K-1 is an integral part of the annual partnership tax return. The K-1 reports a partner's allocable share of partnership ordinary income and separately-stated items, such as dividends, long-term capital gains, etc. A K-1 is prepared for each partner in the partnership and is filed with Form 1065. So, if a partnership has ten partners, there will be ten K-1s that allocate the total partnership income to each partner. A copy of each partner's K-1 is provided to the partners so that they can report the information on their own tax returns. pp. I:1-21 and I:1-22.

I:1-24 Quint's taxable income for 2021 is computed as follows:

Allocable share of PDQ Partnership income ($150,000 x .3333)	$50,000
Other income	15,000
Adjusted gross income (AGI)	$65,000
Standard deduction	$(12,550)
Taxable income	$52,450

The $30,000 distribution from the partnership is considered a return of capital and is not taxable to Quint. Since he reports his allocable share of partnership income, if the distribution were taxed again, the result would be double taxation. If the partnership is eligible for the 20% qualified business income (QBI) deduction, Quint would also be allowed a deduction of $10,000 ($50,000 x 0.20) for his share of partnership income. pp. I:1-17 and I:1-21.

I:1-25 Because of the vast volume of tax law sources, it is impossible for any person to have recall knowledge of the entire tax law. Thus, the ability to understand what the relevant sources of tax law are, their relative weight (importance), and where to find the sources are vital to a person working in the tax area. p. I:1-24.

I:1-26 Even though the Code is the highest authority of tax law sources, the Code contains general language and does not address the many specific situations and transactions that occur. To resolve tax questions concerning specific situations, administrative rulings and court decisions are an integral part of the income tax law. p. I:1-24.

I:1-27 a. Ways and Means Committee (House of Representatives), Senate Finance Committee (U.S. Senate) and the Joint Conference Committee.

b. Committee reports are helpful for two major purposes: (1) to explain the new law before the Treasury Department drafts regulations on the tax law changes, and (2) to explain the intent of Congress for passing the new law. pp. I:1-24 through I:1-26.

I:1-28 The National Office of the IRS issues revenue rulings to provide guidance to taxpayers on specific factual situations, processes ruling requests from taxpayers (private letter rulings), and prepares Revenue Procedures that assist taxpayers with compliance matters. Of course, the National Office also provides administrative and human resources functions at the top level of the organization. p. I:1-26.

I:1-29 Individuals most likely to be audited include those that may be involved in any of the following situations:

- Individuals who are sole proprietors and incur significant expenses in connection with the trade or business.

- Itemized deductions in excess of an average amount for the person's income level.
- Filing of a refund claim by a taxpayer who has been previously audited and the audit resulted in a substantial tax deficiency.
- Individuals who are self-employed with substantial business income or income from a profession such as a medical doctor. p. I:1-27.

I:1-30 a. Rarely will the IRS review each line of Anya's return. Audits of individual taxpayers generally focus on selected items on the return. Note to Instructor: In prior years, the IRS had a Taxpayer Compliance Measurement Program (TCMP) where a small number of taxpayers were selected by a random sample and their returns were audited on a line-by-line basis. These audits were primarily for statistical purposes. Currently, this program has been abandoned. However, the IRS now uses the National Research Program (NRP) to select returns for audit. The NRP will update data compiled in the old TCMP audits and develop new statistical models for identifying returns most likely to contain errors.

b. Generally not all items on a return will be audited. All tax returns are initially checked for mathematical accuracy and items that may be considered clearly erroneous. If differences are noted the IRS sends the taxpayer a bill for the corrected amount. Upon an audit of Anya's return, the IRS generally only examines selected items on the return. These items are those that the IRS believes there is a possibility of error. p. I:1-27.

I:1-31 a. The term "hazards of litigation" refers to the probability of winning or losing a case if it goes to court.

b. Because of the possibility that a case may be lost and the cost of litigation, both the IRS and taxpayers frequently settle a case to avoid such possibilities. The IRS may also decide to settle a case because it does not want to establish an unfavorable precedent of cases in a specific area. A taxpayer may settle a case to avoid substantial legal and professional fees. p. I:1-29.

I:1-32 No, just because the taxpayer has filed a return and received a refund, the IRS may still audit a taxpayer. Tax returns that are selected for audit generally are audited a year or two after the return is received by the IRS. p. I:1-28.

I:1-33 a. The statute of limitations remains open indefinitely if a fraudulent return is filed or if no return is filed at all.

b. The general rule for the disallowance of tax deduction items is that an assessment may be made against the taxpayer within three years from the later of the date the tax return was filed or its due date.

c. A six-year statute of limitations applies if the taxpayer omits an item of gross income that is in excess of 25 percent of the gross income that is reported on the return. p. I:1-28.

I:1-34 The best possible defensibly correct solution is one that is advantageous to the client but is based upon substantial authoritative support (e.g., favorable court cases) even though the position may be challenged upon audit by the IRS. p. I:1-30.

I:1-35 The four principal areas of activity for the profession of tax practice are: tax compliance and procedure, tax research, tax planning and financial planning. Tax compliance and procedure essentially consists of tax return preparation and assisting the taxpayer in dealing with the IRS.

Tax research is the process of developing the most defensibly correct solution to a tax problem. Tax planning involves the process of reducing taxes so as to maximize a taxpayer's after-tax return. Financial planning, while not exclusively related to tax, is a relatively new area for tax professionals to assist clients with planning for their entire financial affairs. pp. I:1-29 through I:1-31.

I:1-36 a. Because income taxes may exceed 50% of a taxpayer's income (including federal, state, and local income taxes and Social Security taxes), taxes are an extremely important part of the financial planning process. Any financial plan that does not carefully consider taxes is a flawed plan.

b. Because tax professionals see their clients at least once a year at a minimum (preparation of their income tax returns) and are familiar with the client's financial information, this represents a perfect opportunity to perform financial planning. p. I:1-31.

I:1-37 No, the principal goal of tax planning is to maximize a taxpayer's after-tax cash flow, not just the minimization of taxes due. For example, if a taxable investment generates a better return after taxes are paid than a nontaxable investment, the taxable investment is superior even though taxes must be paid. p. I:1-30.

I:1-38 Tax planning involves the evaluation of alternative courses of action. The evaluation of alternative courses of action can be very time-consuming because of the numerous and complex tax calculations necessary to arrive at an optimal solution. Using tax software has become an essential tool in this process because of the speed and accuracy in which tax calculations can be made as well as data analytic methods to analyze large amounts of tax data. pp. I:1-30 and I:1-31.

Problems

I:1-39 a.

Income:		
Salary		$ 100,000
Business income		25,000
Interest income		10,000
		$135,000
Deductions:		
Business expenses	$9,500	
Itemized deductions	20,000	29,500
Taxable Income		$105,500
Tax		$19,341

Note: Tax-exempt bond interest is not taxable and itemized deductions are greater than the standard deduction amount.

b. Marginal rate = 24% (From tax rate schedule)
Average rate = 18.33% ($19,341/$105,500)
Effective rate = 14.82% ($19,341/($135,000 + $5,000 - $9,500))

c. From a tax planning point of view, the marginal rate is the most important rate because it measures the tax saving from each additional $1 of deduction (or additional tax from each additional $1 of taxable income). pp. I:1-4 through I:1-7 and I:1-17 and I:1-18.

I:1-40. The income tax payable, average tax rate, and marginal tax rate for each amount is as follows:

a. $1,990 + .12($30,000 - $19,900) = $3,202
Average tax rate: $3,202/$30,000. = 10.67%

Marginal tax rate: 12%

b. $9,328 + .22($100,000 - $81,050) = $13,497

Average tax rate: $13,497/$100,000. = 13.50%

Marginal tax rate: 22%

c. $67,206 + .32($375,000 - $329,850) = $81,654

Average tax rate: $81,654/$375,000. = 21.77%

Marginal tax rate: 32%

d. $168,994 + .37($700,000 - $628,300) = $195,523

Average tax rate: $195,523/$700,000 = 27.93%

Marginal tax rate: 37%

Instructor note: This problem clearly demonstrates the progressive nature of the federal income tax. The average tax rate rises from 10.67% to 27.93% in this problem.

I:1-41 a. Their marginal tax rate with $425,000 of taxable income is 35%. However, with an additional $40,000 of deductions, their taxable income drops to $385,000, which would reduce their marginal tax rate to 32% (for 2021, the 35% rate begins when taxable income exceeds $418,850).

b. Their tax savings using the 2021 Tax Rate Schedules and married filing jointly would be computed as follows:

Tax on $425,000	$97,839
Tax on $385,000	(84,854)
Tax savings	$ 12,985

pp. I:1-4 through I:1-7.

I:1-42 Betty's taxable gift for the current year (2021) is $85,000 computed as follows:

Gift to daughter		$100,000
Gift to husband		40,000
Total gifts during year		$140,000
Annual exclusion ($15,000 x 2)	$30,000	
Marital deduction ($40,000 - $15,000)	25,000	(55,000)
Taxable gifts		$85,000

Note: Charitable contributions are not subject to the gift tax. Thus, the contribution to her church is not subject to the gift tax. pp. I:1-8 and I:1-9.

I:1-43 a. The amount of Clay's taxable estate is $8,225,000. This amount is computed as follows:

Gross estate	$8,500,000
Minus: Funeral and Admin. Expenses	(125,000)
Debts	(150,000)
Taxable Estate	$8,225,000

b. The tax base for computing Clay's estate tax is $ 8,225,000, computed as follows:

Taxable estate	$8,225,000
Gifts after 1976	0
Estate tax base	$8,225,000

c. If the tentative estate tax is $3,235,800, no estate tax is due, computed as follows:

Estate tax from rate schedule	$3,235,800*
Minus: Unified tax credit (2021)	
based on an equivalent of $11,700,000	(4,625,800)
Estate tax due	$0

*[$345,800 + .40 (8,225,000 – 1,000,000)]

d. Yes, because the aggregate value of the estate decreased during the six-month period following the date of death, the alternate valuation date may be selected by the administrator. The important factors in deciding whether to use the alternate valuation date are (1) the amount of estate taxes to be saved, and (2) the impact on the beneficiaries' income tax situation. However, in this case, the alternate valuation date would not be necessary because the estate tax using date-of-death value is zero.

Note: There can never be a tax refund even if the unified credit is greater than the tax liability.

e. If the gross estate was $18,500,000, the taxable estate and tax base would be $18,225,000 ($18,500,000 - $125,000 - $150,000). The estate tax would be as follows:

Estate tax from rate schedule	$7,235,800
Minus: Unified tax credit (2021) based on an equivalent of $11,700,000	(4,625,800)
Estate tax due	$2,610,000

pp. I:1-9 and I:1-10.

I:1-44 a. The corporate tax liability of KT, Inc. for 2021 would be computed as follows:

Gross income	$2,000,000
Expenses: Operating expenses	(800,000)
Taxable income	$ 1,200,000
Corporation tax ($1,200,000 x 0.21)	$ 252,000

The tax liability of Keith and his wife on their individual return for 2021 is as follows:

Dividend from KT, Inc.	$350,000
Other taxable income	130,000
Adjusted Gross Income (AGI)	480,000
Itemized deductions	(40,000)
Taxable income	$440,000
Income tax (joint return rate schedule):	
Taxable income (above)	$440,000
Minus: dividends	(350,000)
Taxable income without dividends	$ 90,000
Tax from rate schedule on $90,000	$ 11,297
Tax on dividends ($350,000 x 15%*)	52,500
	$ 63,797

Thus, the total tax liability for both the corporation (Keith's share of 50%) and Keith and his wife is $189,797 ($126,000 + $63,797).

b. If the consulting business was organized as an LLC, the income taxes would be as follows:

KT, LLC

Gross income	$2,000,000
Operating expenses	(800,000)
Taxable income	$1,200,000
Income tax	$ 0

LLC's are flow-through entities and are not subject to income taxes on the entity.

The tax liability of Keith and his wife on their individual return for 2021 is as follows:

Pass-through income from KT, LLC	$600,000
Other taxable income	130,000
Adjusted gross income (AGI)	730,000
Itemized deductions	(40,000)
Taxable income	$690,000
Income tax (joint return rate schedule, rounded)*	$ 191,823

*Keith would also be subject to self-employment taxes on the $600,000 from KT,LLC. This amount is not shown in this problem. Self-employment taxes are covered later in this textbook.

In this case, as seen from the tax calculations above, when the consulting business is organized as an LLC, slightly increased income taxes result (an increase of $2,026, calculated as the difference between their tax as an LLC of $191,823 minus their tax as a C Corporation of $189,797.) This results even though the dividends are taxed at a rate of 15%. Also, the $700,000 of LLC distributions ($350,000 each) are not subject to income taxation. pp. I:1-19 through I:1-23.

Note to Instructor: This extremely simplified problem is intended to illustrate the onerous effect of double taxation of C corporations and shareholders. Prior to 2018, the tax effect was much more significant. The reduction of C corporation tax rates to 21% (from 35%) has substantially reduced the tax advantage of flow-through entities. However, the 20% deduction for flow-through entities would further enhance the viability of flow-through entities.

I:1-45 Howard and Dawn's taxable income and income tax liability for 2021 is computed as follows:

Dawn's salary			$ 40,000
Allocable share of partnership income ($180,000 x 0.40)			72,000
Qualified dividends ($4,000 + $3,000)			7,000
Net long-term capital gain [($28,000 - $12,000) x 0.40]			6,400
Adjusted gross income (AGI)			$125,400
Larger of itemized deductions or standard deduction:			
Standard deduction, or		$25,100	
Itemized deductions:			
Mortgage interest	$12,000		
Real estate taxes	5,800		
Charitable contributions ($1,600 + $3,000)	4,600	22,400	(25,100)
Taxable income			$100,300

Income tax liability (from tax rate schedules, see calculations below)			$ 12,625*
Income tax payments made during the year:			
Tax withheld from salary		$ 4,500	
Estimated tax payments		10,000	14,500
Refund			$ 1,875

*$100,300 – (7,000 + 6,400) = 86,900; tax	$10,615
Dividends and LTCG: ($13,400 x 0.15)	2,010
Total tax liability	$12,625

Note: The cash distributions of $150,000 are not subject to income taxation for the partners. Also, Howard would likely be subject to self-employment taxes which are substantial. Self-employment taxes are covered in Chapter I:14 of this textbook.
pp. I:1-17 through I:1-19.

I:1-46 Since Paul's return is filed late and the final balance due on the return is paid late (both due on or before April 15, 2021), Paul is subject to further interest and penalties on his 2020 income tax return. Both interest and penalties are computed on the net tax due or, in this case, $8,000 (the difference between the tax liability and the withholdings). The interest and penalties are computed as follows (assuming a 3% interest rate on underpayments on tax and the return is 232 days late):

Interest: $8,000 x 3% x 232/365 = $152.55.

There are two penalties to which Paul would be subject, a failure to file (timely) penalty and a failure to pay the tax (timely) penalty. The late payment penalty is .5% per month to a maximum of 25%; the late filing penalty is 5% per month to a maximum of 25%. However, both penalties are not assessed together. If both penalties apply, the failure to file penalty is reduced by .5%.

Failure-to-pay penalty (0.5% per month to a maximum 25%):
Based on filing the return 9 months late:

Tax due	$8,000.00
Lesser of (a) 0.5% × 9 or (b) 25%	× 4.5%
Failure-to-pay penalty	$ 360.00

Failure-to-file penalty (5% per month to a maximum 25%, reduced by the failure-to-pay penalty for each month both penalties apply):

Tax due	$8,000.00
Lesser of (a) 5% × 9 or (b) 25%	× 25%
Failure-to-file penalty before reduction	$2,000.00
Failure-to-pay penalty for 5 months*	(200.00)
Failure-to-file penalty	$1,800.00

*0.5% × 5 months × $8,000 = $200.00. Because the 5% per month penalty has a 25% maximum, it applied for only 5 months. See IRM Sec. 8.17.7.3.

Thus, Paul must pay an additional $152.55 of interest plus $2,160.00 ($360.00 + $1,800.00) of penalties for filing the return late, for a total cost of $2,312.55 for filing late. Obviously, Paul would be prudent to file his return in a timely manner. pp. I:1-28 and I:1-29.

I:1-47 a. Of the three individuals, Connie would most likely be audited. Individuals who have unincorporated businesses that produce significant tax losses are likely to get audited by the IRS.

b. Craig is not likely to be audited.

c. Dale is not likely to be audited. However, it is likely that the Form 1099 will be checked against the reported amount and the IRS Center will send Dale a bill for the corrected amount of tax. p. I:1-27.

I:1-48 The statute of limitations will not prevent the IRS from issuing a deficiency assessment for all three years of 2012, 2017, or 2019. Dan's taxes from 2012 can be assessed because the statute of limitations remains open indefinitely if no return is filed.

The $40,000 of unreported gross income from 2017 is taxable. A six-year statute of limitations applies if the taxpayer omits an item of gross income that is in excess of 25% of the reported gross income. In this case reported gross income was $60,000. $40,000 is greater than $15,000 (0.25 x $60,000).

The $600 unsubstantiated business travel and entertainment deduction are disallowed in 2019 and gross income will be increased in 2019 because an assessment may be made against the taxpayer within three years from the later of the due date or the date the tax return was filed. In this case the omission occurred in 2019. p. I:1-28.

Tax Strategy and Critical Thinking Problem

I:1-49 Pedro is in a good position to begin a gifting program to his children. Since he has such a significant portfolio of stocks and bonds, he could make annual gifts of $15,000 of stocks and bonds in 2021 and future years to each of his children. The effect of these gifts is to shift the dividends and interest from Pedro (at his high rate) to the children (at their low rates) as well as removing these assets from Pedro's estate upon his death. Since the children have no income, the dividends and interest would be taxed to the older two children at the lowest marginal income tax rates.

As will be discussed in Chapter I:2 of this text, the children will be taxed at special rates for much of the income shifted to them per the so-called "kiddie tax." Thus, the shifting of investment income is not effective for children under the age of 18 (or 24 and in college). Also, Pedro and his wife can actually gift $30,000 ($15,000 x 2) per year for each child and over a few years, a sizeable amount of assets can be transferred to the children. To protect the assets, the gifts can be made to trusts rather than directly to the children to insure that the children do not make bad decisions during their youthful years.

There are many other aspects of this type of tax strategy but this problem is intended to demonstrate both the income and estate tax savings that can be accomplished through the making of annual gifts.

Case Study Problem

I:1-50

- The apartment buildings constitute a rental activity and are subject to the passive activity rules of Section 469 of the Internal Revenue Code. Since Rick's adjusted gross income (AGI) is greater than $150,000 before the loss, he would be unable to currently deduct the losses on his personal income tax return. Therefore, the $100,000 of losses in each of the first three years would not be deductible. However, the losses would be considered as suspended passive losses and would be available as a deduction against the rental income in future years.
- The blueberry farm, while requiring a substantial cash outlay, would not result in as much a loss as Rick believes. The reason is that most of the cash outlays must be capitalized and, if allowed, depreciated over several years rather than deducted currently. The land would not be depreciated at all. Both the equipment and blueberry plants must be capitalized and depreciated. So, while he may not get as much of a current deduction, he still would be able to claim the deductions in future years when the farm begins generating revenue.
- Rick is correct about using appreciated stock as a charitable contribution. If he gave his entire amount of stock to charitable organizations, he would receive a $200,000 charitable deduction in the year of the contribution. He would not be required to recognize any of the appreciation as income on his tax return. See Section 170 of the Internal Revenue Code for details.

Tax Research Problem

I:1-51 In CIR v. Court Holding Co. the main issue was whether the petitioner should have been taxed on the gain realized on the sales of all its assets, or whether the sale was made by its stockholders individually after distribution of the assets to them in complete liquidation. The sole asset in the corporation was an apartment house. All of the outstanding stock was owned by a husband and wife. Negotiations took place between the corporation, a sister and brother-in-law, and lessees of the building to sell the property. Just prior to putting the sale in writing, the corporation's attorney advised the husband and wife that this sale would cause a large tax to the corporation. The next day the corporation declared a "liquidating dividend" which deeded the property to the husband and wife, who in turn surrendered all of their stock. A sales contract was then drawn between the husband and wife and the lessees of the building for sale of the property. The $1,000 that was previously paid to the corporation was given to the husband and wife as a down payment. The property was then conveyed to the lessees.

The Tax Court found that the corporation had not abandoned the sales negotiations. "A sale by one person cannot be transferred for tax purposes into a sale by another by using the latter as a conduit through which to pass title." The Supreme Court upheld the Tax Court's findings that the sale was actually a sale by the corporation and the necessary taxes were imposed. The Supreme Court held that the incidence of the transaction depends upon the "substance" of the transaction and that the separate steps previously described should be viewed as a whole transaction.

In U.S. v. Cumberland Public Service Co. the issue was essentially the same. Who actually made the sale, the corporation or the shareholders? The Cumberland Public Service Company was in the business of generating and distributing electric power. A local cooperative began to distribute power in the area serviced by Cumberland. The competing company had more efficient means of generating electricity. Cumberland offered to sell all of its stock to the competing company. The company refused the offer but countered with an offer to buy the transmission and distribution equipment of Cumberland. Cumberland refused because under such a deal it would have been subject to a heavy capital gains tax. Shareholders of Cumberland offered to buy the corporate property and then sell the property to the competing corporation. The Court of Claims found that the shareholders did actually make the sale and that at no time was the corporation ever planning to make such a sale. In addition, the court held that the liquidation and dissolution genuinely ended the corporation's activities and existence. The Supreme Court upheld the Court of Claims findings.

While the Court Holding Co. and Cumberland Public Service Co. cases appear to revolve around very similar facts, the courts have ruled that the steps of such transactions must be explored as well as the end result. The Cumberland Public Service Company was able to show that the liquidation and dissolution genuinely ended the corporation's activities and existence so that the shareholders acted on their own behalf when they executed the previously contemplated sale to the cooperative.

Chapter C:1

Tax Research

Note: To do the online research problems for this chapter, textbook users must have access to an Internet-based tax service at their institution. Solutions are provided using RIA Checkpoint, when applicable. In some cases, solutions using other tax services may differ.

Discussion Questions

C:1-1 In a closed-fact situation, the facts have occurred, and the tax advisor's task is to analyze them to determine the appropriate tax treatment. In an open-fact situation, by contrast, the facts have not yet occurred, and the tax advisor's task is to plan for them or shape them so as to produce a favorable tax result. p. C:1-2.

C:1-2 According to the AICPA's Statements on Standards for Tax Services, the tax practitioner owes the client the following duties: (1) to inform the client of (a) the potential adverse consequences of a tax return position, (b) how the client can avoid a penalty through disclosure, (c) errors in a previously filed tax return, and (d) corrective measures to be taken; (2) to inquire of the client (a) when the client must satisfy conditions to take a deduction and (b) when information provided by him or her appears incorrect, incomplete, or inconsistent on its face; and (3) not to disclose tax-related errors without the client's consent. pp. C:1-31 through C:1-33.

C:1-3 When tax advisors speak about "tax law," they refer to the IRC as elaborated by Treasury Regulations and administrative pronouncements and as interpreted by federal courts. The term also includes the meaning conveyed by committee reports. p. C:1-7.

C:1-4 Committee reports concerning tax legislation explain the purpose behind Congress' proposing the legislation. Transcripts of hearings reproduce the testimonies of the persons who spoke for or against the proposed legislation before the Congressional committees. Committee reports are sometimes used to interpret the statute. p. C:1-7.

C:1-5 Committee reports can help resolve ambiguities in statutory language by revealing Congressional intent. They are indicative of this intent. pp. C:1-7 and C:1-8.

C:1-6 The Internal Revenue Code of 1986 is updated for every statutory change to Title 26 subsequent to 1986. Therefore, it includes the post-1986 tax law changes enacted by Congress and today reflects the current state of the law. p. C:1-8.

C:1-7 No. Title 26 deals with all taxation matters, not just income taxation. It covers estate tax, gift tax, employment tax, alcohol and tobacco tax, and excise tax matters. p. C:1-8.

C:1-8 a. Subsection (c). It discusses the tax treatment of property distributions in general (e.g., amount taxable, amount applied against basis, and amount exceeding basis).

b. Because Sec. 301 applies to the entire chapter, one should look throughout that entire chapter (Chapter 1 of the IRC – which covers Sec. 1 through Sec. 1400U-3) for any exceptions. One special rule – Sec. 301(e) – is found in Sec. 301. This special rule explains the tax treatment of dividends received by a 20% corporate taxpayer. Section 301(f) indicates some of the important special rules found in other IRC sections.

c. Legislative. Section 301(e)(4) authorizes the issuance of Treasury Regulations as may be necessary to carry out the purposes of the subsection. pp. C:1-9 through C:1-10.

C:1-9 Researchers should note the date on which a Treasury Regulation was adopted because the IRC may have been revised subsequent to that date. That is, the regulation may not interpret the current version of the IRC. Discrepancies between the IRC and the regulation occur when the Treasury Department has not updated the regulation to reflect the statute as amended. p. C:1-9.

C:1-10 a. Proposed regulations are not authoritative, but they do provide guidance concerning how the Treasury Department interprets the IRC. Temporary regulations, which are binding on the taxpayer, often are issued after recent revisions to the IRC so that taxpayers and tax advisers will have guidance concerning procedural and/or computational matters. Final regulations, which are issued after the public has had time to comment on proposed regulations, are considered to be somewhat more authoritative than temporary regulations. pp. C:1-9 and C:1-10.

b. Interpretative regulations make the IRC's statutory language easier to understand and apply. They also often provide computational illustrations. In the case of legislative regulations, Congress has delegated the rulemaking on a specific topic (either narrow or broad) to the Treasury Department. However, after the Mayo Foundation case, both types of regulations will have the same authoritative weight. p. C:1-10.

C:1-11 Prior to 2011, courts gave more authority to legislative regulations than to interpretive regulations. However, after the Supreme Court decision in Mayo Foundation, courts will hold both interpretive and legislative regulations to the same standard and will overturn them only in very limited cases. p. C:1-10.

C:1-12 Under the legislative reenactment doctrine, a Treasury Regulation is deemed to have been endorsed by Congress if the regulation was finalized before a related IRC provision was amended by Congress and in the interim, Congress did not amend the statutory provision to which the regulation relates. p. C:1-10.

C:1-13 a. Revenue rulings are not as authoritative as court opinions, Treasury Regulations, or the IRC. They represent interpretations by an interested party, the IRS. p. C:1-12.

b. If the IRS audits the taxpayer's return, the IRS likely will contend that the taxpayer should have followed the ruling and, therefore, owes a deficiency. p. C:1-12.

C:1-14 a. The Tax Court, the U.S. Court of Federal Claims, or the U.S. district court for the taxpayer's jurisdiction. p. C:1-14.

b. The taxpayer might consider the precedent, if any, existing within each jurisdiction. The taxpayer might prefer to avoid expending cash to pay the proposed deficiency. If so, the taxpayer would want to litigate in the Tax Court. If the taxpayer would like to have a jury trial address questions of fact, he or she should opt for the U.S. district court. pp. C:1-14 through C:1-19, p. C:1-21, and p. C:1-23.

c. Appeals from Tax Court and U.S. district court decisions are made to the circuit court of appeals for the taxpayer's geographical jurisdiction. U.S. Court of Federal Claims decisions are appealable to the Court of Appeals for the Federal Circuit. Appeals from any of the circuit courts of appeals may be brought to the U. S. Supreme Court. pp. C:1-20 through C:1-21.

C:1-15 No. A taxpayer may not appeal a case litigated under the Tax Court's Small Cases Procedure. p. C:1-17.

C:1-16 Tax Court regular and memo decisions have about the same precedential value. Decisions issued under the Small Cases Procedure of the Tax Court have little or no precedential value. pp. C:1-15 and C:1-17.

C:1-17 Yes. The IRS can acquiesce (or nonacquiesce) in any federal court decision that is adverse to the IRS if the IRS decides to do so. In many cases the IRS does not acquiesce or nonacquiesce. p. C:1-17.

C:1-18 In both the AFTR and USTC: decisions of U.S. district courts, U.S. bankruptcy courts, U.S. Court of Federal Claims, circuit courts of appeal, and the U.S. Supreme Court. Tax Court decisions are reported in neither of the two reporters. pp. C:1-16 and C:1-17 through C:1-22.

C:1-19 Prior to 2009, revenue rulings appeared in the weekly Internal Revenue Bulletin (I.R.B.), and twice each year the decisions published in the I.R.B. were bound together and published in the Cumulative Bulletin (C.B.). For pre-2009 rulings, the I.R.B citation was temporary and was replaced by a citation to the C.B. After 2008, the IRS no longer publishes the Cumulative Bulletin. Therefore for current rulings, the initial I.R.B. citation is final. p. C:1-12.

C:1-20 According to the Golsen Rule, the Tax Court will not follow a decision it made earlier, but rather will follow a decision of the circuit court of appeals to which the case under consideration is appealable. As an example, assume that the Tax Court, in a case involving a First Circuit taxpayer, ruled for the taxpayer. The issue had not been litigated earlier. Then, a U.S. district court in Georgia decided a case involving the same issue in favor of another taxpayer. The Eleventh Circuit, however, reversed the decision. Now a taxpayer from the Eleventh Circuit litigates the same issue in the Tax Court. Under the Golsen Rule, the Tax Court will follow the Eleventh Circuit's decision favoring the government. The Tax Court need not follow an appeals court decision if a case was litigated by a taxpayer whose appeal would have been made to any circuit other than the Eleventh. p. C:1-21.

C:1-21 a. The precedent binding upon a California taxpayer would be the Tax Court case. The Tax Court has national jurisdiction. pp. C:1-21 and C:1-23.

b. Under the Golsen Rule, the Tax Court will depart from its earlier decision and follow the Fifth Circuit's decision favoring the government. p. C:1-21.

C:1-22 a. Congressional Record
b. Internal Revenue Bulletin
c. Tax Court of the United States Reports
d. Federal Register, Internal Revenue Bulletin, and/or Cumulative Bulletin
e. Federal Supplement, American Federal Tax Reports (only tax-related), United States Tax Cases (only tax-related).
f. Not found in an "official" publication; published by tax services

pp. C:1-7, C:1-12 through C:1-14, and C:1-17 through C:1-19.

C:1-23 A tax advisor might find the provisions of a tax treaty useful where a U.S. taxpayer engages in transactions in a foreign country. The United States has tax treaties with over 55 countries. p. C:1-24.

C:1-24 Citators (1) trace the history of the case in question and (2) list other authorities that have cited such case. p. C:1-30.

C:1-25 Revenue rulings, revenue procedures, and judicial decisions. p. C:1-29.

C:1-26 Keyword, index, or citation are the three ways to search in tax service databases. p. C:1-26.

C:1-27 a. The principal primary sources found in CHECKPOINT are as follows:

- IRC
- Treasury Regulations
- Court opinions
- Revenue rulings and procedures
- Letter rulings
- Committee reports
- Tax treaties

b. The principal secondary sources found in CHECKPOINT are as follows:

- Federal Tax Coordinator
- United States Tax Reporter
- Warren, Gorham & Lamont journals and treatises

Secondary sources will differ among the tax services. pp. C:1-26 through C:1-29.

C:1-28 The features (i.e., icons, templates, and command buttons) will vary depending upon the particular tax service/Internet site accessed. Just about all commercial tax databases can be searched by keyword and citation. Some can be searched by table of contents and topic. Most noncommercial tax databases can be searched by keyword. Some can be searched by citation and table of contents.

The advantages of using a commercial tax service (as opposed to a noncommercial service) are broader database scope, greater historical coverage, and more efficient search engines. The principal disadvantage is cost.

Because of their relative disadvantages, the noncommercial sites should not be regarded as a substitute for a commercial tax service. Access is non-uniform. The scope and breadth of their databases are limited. pp. C:1-26 through C:1-28.

C:1-29 The CPA should have a good faith belief that his or her position has a realistic possibility of being sustained administratively or judicially on its merits if challenged. p. C:1-31.

C:1-30 Under the AICPA's Statements on Standards for Tax Services (SSTSs), a tax preparer is not obligated (1) to verify client provided information if the information is not suspicious on its face and (2) to update professional advice based on developments following its original conveyance. p. C:1-31.

C:1-31 This answer lists six requirements. Under Circular 230, the practitioner is expected to: (1) base the advice on reasonable assumptions, (2) consider relevant facts and circumstances, (3) identify the facts relevant to the advice, (4) be properly skeptical of representations by the taxpayer and others, (5) relate applicable law and authority to the facts, and (6) not base an opinion on the chances that a transaction will be identified by IRS and subject to audit. p. C:1-30.

C:1-32 Circular 230 is a government issued document that dictates rules for practicing before the IRS. The Statements on Standards for Tax Services (SSTSs) are ethical standards issued by the AICPA aimed at tax practitioners. Circular 230 applies only to federal tax issues, and the SSTSs apply to both federal and state issues. Circular 230 only applies to income taxes, and the SSTSs apply to all types of taxes. Finally, Circular 230 does not provide the same depth of ethical guidance found in the SSTSs. p. C:1-30.

Problems

C:1-33 a. Yes. According to Secs. 71(a) and (b), the wife includes $25,000 per year. Also, the divorce agreement must explicitly state that the husband has no liability to make payments after the wife's death. See Sec. 71(b)(1)(D) and Temp. Reg. Sec. 1.71-1T(b), Q-11.

b. Yes. The husband deducts $25,000 per year according to Secs. 215(a) and (b). According to Sec. 62(a)(10), the alimony is deductible for AGI.

c. For alimony agreements after December 31, 2018, Secs. 71 and 215 are repealed. pp. C:1-8 and C:1-26 through C:1-29.

C:1-34 a. Legislative. According to Sec. 385(a), "The Secretary is authorized to prescribe such regulations as may be necessary or appropriate. . . ."

b. Yes. Section 385(a) states that the regulations will be applicable "for purposes of this title." "This title" is Title 26 of the federal statutes. Because Title 26 encompasses all tax statutes, the regulations would be relevant for estate tax purposes. pp. C:1-8 through C:1-10 and C:1-26 through C:1-29.

C:1-35 a. Both rulings hold that contributions to a fund formed to acquire a portrait of a former judge and donated to a governmental agency are deductible under Sec. 170. pp. C:1-12 and C:1-13.

b. Private letter rulings cannot be cited as precedence and apply only to the taxpayer for whom the IRS issued the ruling. pp. C:1-12 and C:1-13.

c. Revenue rulings can be cited as precedence, and they are relied on by both taxpayers and the IRS for guidance in particular factual situations. pp. C:1-12 and C:1-13.

C:1-36 Sections 355 and 856. The official IRS publication is the Internal Revenue Bulletin, which eventually is incorporated into the Cumulative Bulletin. pp. C:1-12 and C:1-29.

C:1-37 Results might vary as the online service adds or deletes documents, but as of this writing:

a. 300.

b. 169.

c. 69.

C:1-38 The following results were obtained using RIA Checkpoint. Results using other tax services may vary.

a. 14.

b. 8 using 'home office' without quotations, 4 with quotes around the term.

c. The results after refining for "home office" are more relevant primarily because 280A also covers issues related to rental and vacation homes and refining the results omits these references. The search within results output produced revenue rulings related to home office issues, and the first result is to a revenue ruling explaining how the IRS would interpret an important Supreme Court case addressing home office deductions. pp. C:1-26 through C:1-28.

C:1-39 a. Acquiescence. See AOD 1986-030, 1986-1 C.B. 1.

b. No. The acquiescence was only with respect to whether a transfer to the taxpayer's spouse is a taxable disposition. pp. C:1-17 and C:1-29.

C:1-40 a. Acquiescence. See AOD 2016-02.

b. The AOD addressed whether the limitation on home mortgage deductions applied on a per property or per taxpayer business. pp. C:1-17 and C:1-29.

C:1-41 a. Nonacquiescence. See AOD 1988-014, 1988-2 C.B.1.

b. Yes. In 2003, the Commissioner withdrew the 1988 AOD and acquiesced. See AOD 2003-001, 2003-2 I.R.B. pp. C:1-17 and C:1-29.

C:1-42 a. Yes. The case was reviewed by the court. No. It was not a unanimous decision. Judges Korner, Swift, and Gerber did not participate. Judge Simpson dissented. pp. C:1-26 through C:1-29.

b. Yes. The decision was entered under Rule 155. p. C:1-17.

c. Yes. The case was reviewed by the Sixth Circuit Court of Appeals. pp. C:1-26 through C:1-29.

C:1-43 a. Yes. The case was reviewed by the court. The decision was not unanimous. Judge Quealy dissented. Judge Tannenwald issued a concurring opinion with which five judges agreed. Judge Chabot issued a dissenting opinion with which three judges agreed, and Judge Nims issued a dissenting opinion with which three judges agreed. pp. C:1-26 through C:1-29.

b. No. The decision was not entered under Rule 155. p. C:1-17.

c. Yes. The case was reviewed by the Sixth Circuit Court of Appeals in 1982. pp. C:1-26 through C:1-29.

C:1-44 a. National Cash Register Co. v. U.S., 400 F.2d 820, 22 AFTR 2d 5562, 68-2 USTC ¶9576 (6th Cir., 1968).

b. Thomas M. Dragoun, 1984 RIA T.C. Memo ¶84,094 (T.C. Memo 1984-94), 47 TCM 1176.

c. U.S. v. John M. Grabinski, 558 F. Supp. 1324, 52 AFTR 2d 83-5169, 83-2 USTC ¶9460 (DC MN, 1983).

d. U.S. v. John M. Grabinski, 727 F.2d 681, 53 AFTR 2d 84-710, 84-1 USTC ¶9201 (8th Cir., 1984).

e. Rebekah Harkness v. U.S., 469 F.2d 310, 30 AFTR 2d 72-5754, 72-2 USTC ¶9740 (Ct. Cl., 1972). Note that during this period, Court of Claims decisions were published in the Federal Reporter, Second Series. Alternatively, you could give the citation 199 Ct. Cls. 721, which references the Court of Claims Reporter. In the RIA citator the name of the case is simply Harkness.

f. Hillsboro National Bank v. CIR, 460 U.S. 370, 51 AFTR 2d 83-874, 83-1 USTC ¶9229 (USSC, 1983).

g. Rev. Rul. 78-129, 1978-1 C.B. 67. pp. C:1-17 through C:1-22.

C:1-45 a. Rev. Rul. 99-7, 1999-1 C.B. 361.

b. Frank H. Sullivan, 1 B.T.A. 93 (1924).

c. Tate & Lyle, Inc., 103 T.C. 656 (1994).

d. Ralph L. Rogers v. U.S., 539 F. Supp. 104, 49 AFTR 2d 82-1160, 82-1 USTC ¶9246 (DC OH, 1982).

e. Norman Rodman v. CIR, 542 F.2d 845, 38 AFTR 2d 76-5840, 76-2 USTC ¶9710 (2nd Cir., 1976). pp. C:1-17 through C:1-22.

C:1-46 a. Circuit Court of Appeals for the Ninth Circuit; page 1198 of Volume 648 of the Federal Reporter, Second Series and page 81-5353 of Volume 48 of the American Federal Tax Reports, Second Series.

b. U. S. Court of Federal Claims; page 455 of Volume 14 of the Claims Court Reporter and paragraph (not page) 9231 of Volume 1 of the 1988 U. S. Tax Cases.

c. Supreme Court; page 13 of Volume 309 of the United States Supreme Court Reports and page 816 of Volume 23 of the American Federal Tax Reports.

d. A U.S. District Court in Texas; page 76 of Volume 441 of the Federal Supplement and page 78-335 of Volume 41 of the American Federal Tax Reports, Second Series.

e. Not a court decision; page 72 of Volume 1 of the 1983 Cumulative Bulletin.

f. Circuit Court of Appeals for Sixth Circuit; page 474 of Volume 568 of the Federal Reporter, Second Series and paragraph (not page) 9199 of Volume 1 of the 1978 U.S. Tax Cases. pp. C:1-16 and C:1-22.

C:1-47 a. A facelift as a deductible medical expense is discussed in ¶K-2109 of the Federal Tax Coordinator. Solutions using other tax services will differ.

b. Section 213.

c. Generally no. Section 213(d)(9) (effective for tax years beginning after 1990) provides that the cost of cosmetic surgery is not deductible except in certain narrow circumstances. pp. C:1-28 and C:1-29.

C:1-48 No. The regulation does not reflect the amendments to Sec. 302 made by P.L. 96-589, P.L. 97-248, P.L. 98-369, and P.L. 111-325. A caution to this effect appears at the beginning of the regulation. pp. C:1-26 through C:1-29.

C:1-49 a. Casualty losses from termite damage are discussed in ¶M-1743 (Federal Tax Coordinator) and Ann ¶1655.3020 (U.S. Tax Reporter).

b. Authorities include: Rev. Rul. 63-232, 1963-2 C.B. 97; Henry L. Sutherland, 1966 PH T.C. Memo ¶66,155, 25 TCM 822; and Martin A. Rosenberg v. CIR, 42 AFTR 2d 303, 52-2 USTC ¶9377 (8th Cir., 1952). The first two authorities denied a deduction and the third allowed a deduction. Textbook users may find additional authority. pp. C:1-28 and C:1-29.

C:1-50 a. More than 35% of the excess of the value of the decedent's gross estate over the sum of allowable Sec. 2053 and 2054 deductions.

b. No. The regulation indicates the test is more than (1) 35% of the gross estate or (2) 50% of the taxable estate. It does not reflect the P.L. 94-455 or P.L. 97-34 amendments to the IRC. A caution to this effect appears before the beginning of the reprint of the regulations. pp. C:1-26 through C:1-29.

C:1-51 a. 645.

b. 572-3rd - Accounting Methods – Adoptions and Changes.
570- 2nd - Accounting Methods – General Principles.

c. 568-4th.

d. 367.

e. 523-2nd.

p. C:1-25.

C:1-52 "Fireman, Allowed; uniform" is discussed at ¶L-3806. Note: The RIA source document does not use the gender neutral phrase "firefighter." The revenue ruling dealing with this topic is Rev. Rul. 70-474, 1970-2 C.B. 34. pp. C:1-27 and C:1-28.

C:1-53 a. 13.

b. 12 issues are listed in the findings of fact.

c. Yes. The Fourth Circuit reviewed the case. pp. C:1-28 and C:1-29.

C:1-54 a. 27.

b. No. According to the headnote to the opinion, the decision dealt with one issue, deductions.

c. No. The decision has not been cited unfavorably. pp. C:1-28 and C:1-29.

C:1-55 a. 1972.

b. The deductibility of the cost of a customer list under Sec. 162.

c. The government. The cost was not currently deductible.

d. No. The decision was not reviewed at the trial level.
e. Yes. The decision was appealed to the Sixth Circuit Court of Appeals.
f. Yes. The RIA citator lists eight citations to the decision. pp. C:1-26 through C:1-29.

C:1-56 a. To file a tax return electronically, one must (1) purchase the requisite software from a commercial vendor or download it from a designated Internet site; (2) obtain a Personal Identification Number (PIN) from the IRS; (3) either prepare a tax return offline and upload, or prepare the return online; and (4) transmit the return to the IRS.

b. The taxpayer can transmit funds electronically in one of three ways: (1) by authorizing an electronic funds withdrawal from a checking or savings account; (2) by authorizing payment by credit card; or (3) by mailing to the IRS a check or money order using a payment voucher.

c. Electronic filing (1) allows the taxpayer to file a return from any personal computer; (2) is more accurate than manual filing; (3) offers the safety and security of direct deposit; (4) offers the convenience of filing a tax return early and delaying payment up to the due date, and (5) allows one to file federal and state tax returns simultaneously. p. C:1-28.

C:1-57 a. "Request for Copy of Tax Return."
b. "Corporation Claim for Deduction for Consent Dividends."
c. "Excise Tax on Greenmail."
p. C:1-28.

C:1-58 a. "Request for Copy of Individual Tax Return."
b. "Corporation Income and Franchise Tax Return."
c. "Partnership Income Tax Return."
p. C:1-28.

C:1-59 The latest data as of this writing was for January 2019.
a. 7 (Alaska, Florida, Nevada, South Dakota, Texas, Washington, Wyoming).
b. 2 (New Hampshire and Tennessee).
c. 9.9%.
d. North Dakota, 2.9%.
p. C:1-28.

Comprehensive Problem

C:1-60 STEP ONE: In searching CHECKPOINT's United States Tax Reporter (USTR), you can do a keyword search for "Advertising yachts." Searching within results for "pennant" reduces the number of results but is not necessary. In USTR, you would likely find an annotation at ¶1625.356(13).

STEP TWO: In print research, you would leave the tax service reporter volume to look up the case on page 879, Volume 36 of Tax Court of the United States Reports. In computerized research, you would remain in the service and click on the hyperlinked citation. Either way, you would find the text of R.L. Henry, 36 T.C. 879. This case involved an attorney/accountant who tried to deduct the costs of insuring and maintaining a yacht on which he flew a pennant with the numerals "1040." It is analogous to your client's case.

STEP THREE: In print research, to check the status of the case, you would leave Tax Court of the United States Reports to consult a citator. In computerized research, you would remain in the service and click on the citator command button. Either way, you would discover a listing of cases that cite R.L. Henry. You also would discover that the case is still "good law."

STEP FOUR: In both print and computerized research, based on the ruling in R.L. Henry, you likely would conclude that the costs of maintaining and insuring the physician's yacht are not deductible as ordinary and necessary business expenses. pp. C:1-26 through C:1-29.

Tax Strategy and Critical Thinking Problem

C:1-61 Choose Alternative 2; file the lawsuit in the Tax Court. HPU is likely to lose a lawsuit filed in the U. S. district court (Alternative 1) because that court is bound by *district court* precedent adverse to the taxpayer. Likewise, HPU is likely to lose a lawsuit filed in the Court of Federal Claims (Alternative 3) because that court is bound by *circuit court* precedent adverse to the taxpayer. On the other hand, in the Tax Court (Alternative 2) the tax return position taken by HPU has a realistic possibility of being sustained on its merits. In a case involving HPU, the Tax Court would not be bound by the other circuit court's precedent, which is adverse to the taxpayer because of the Golsen Rule. Rather, the Tax Court would be bound by HPU's own circuit court precedent, which, based on the specific facts of the problem, is nonexistent because HPU's circuit court has merely offered *dictum*, which is not binding. However, if the Tax Court issues a ruling consistent with the circuit court's second proposition, namely, that by opening the home improvement center, HPU is merely "improving customer access to its existing products," HPU will win the lawsuit, and its deduction will be sustained. pp. C:1-21 and C:1-23.

Case Study Problem

C:1-62 Statements on Standards for Tax Services (SSTS) No. 3 states that a CPA "may in good faith rely, without verification, on information furnished by the taxpayer or by third parties" (Para. 2, reproduced in Appendix E of the text). Thus, you may accept Mal's information at face value. His increase in AGI of over $30,000 may explain his increase in charitable contributions of approximately $10,000. In the second scenario the provision from SSTS No. 3 that a CPA "should make reasonable inquiries if the information furnished appears to be incorrect, incomplete, or inconsistent either on its face or on the basis of other facts known to a member" would be pertinent. Recently, the IRS audited Mal's return, and Mal lacked substantiation for about 75 percent of the charitable contributions he had claimed. (He may have made the contributions, but he could not prove that he did.) Further, the round amount ($25,000) reported by Mal suggests that Mal may be estimating what he contributed. You probably should request to see substantiation (canceled checks, etc.) for the contribution(s) claimed. For charitable contributions of $250 or greater, no deduction is allowed unless the donee organization substantiates the contribution with a contemporaneous, written acknowledgement. Mal needs to be made aware of this rule for his current year's return. All cash contributions, regardless of amount, must be documented with a bank record or written communication from the charity. The communication must include the name of the charity, date, and amount. p. C:1-32.

Tax Research Problems

C:1-63 a. The primary issue is whether the amounts Thomas A. Curtis, M.D. Inc. paid to Ellen Curtis as compensation during fiscal years 1988 and 1989 were reasonable.

b. Neither party was totally victorious. In fiscal year 1988, Ellen Curtis was paid \$410,500. The amount held to be reasonable compensation by the Tax Court for 1988 was \$227,000. In fiscal year 1989, Ellen Curtis was paid \$510,500. The amount held to be reasonable compensation by the Tax Court for 1989 was \$239,000. The amount held to be compensation, however, is more than the \$100,000 and \$105,000 the IRS asserted was reasonable compensation.

c. The plaintiff is the corporation because it is the party that claimed a deduction for the compensation. The IRS is attempting to disallow the corporation's deduction for part of the compensation paid. The disallowance of the deduction will have little effect on the two individuals since the amounts received will be either salary or dividends depending on the outcome of the case.

d. Ellen Barnert married Dr. Thomas Curtis in 1984.

e. Ms. Curtis worked approximately 60 to 70 hours supervising all departments set up within the corporation and the independent contractors, including scheduling and staffing of all the corporation's offices. Ms. Curtis was a registered nurse. She had a bachelor's degree in science and took worker's compensation courses at the University of Southern California Law School. She had worked as a nurse for a number of years and managed an ambulatory hospital system.

f. In fiscal year 1989, Ellen Curtis was paid \$510,500. The Tax Court held \$239,000 to be reasonable compensation in 1989.

g. The corporation paid no dividends in either fiscal year.

h. The case is appealable to the Ninth Circuit.

i. The five factors mentioned in determining reasonable compensation according to <u>Elliott's</u> are: (1) the employee's role in the company, (2) external comparison of the employee's salary with those paid by similar companies for similar services, (3) character and condition of the company, (4) conflict of interest in the employee's relationship to the corporation, and (5) the internal consistency in the company's treatment of payments to employees.

C:1-64 Judicial authority exists to exclude the Medicare payments from the amount the mother is treated as having provided for her own support. The IRS agrees with this authority; therefore, if the IRS audits the client's return, the IRS will not argue that Josh's mother provided the majority of her own support. (This information should be included in the client letter.)

The work papers should include a discussion of the authorities summarized below. Section 152(a) provides that one of the tests for claiming another as a dependent is to provide over one-half of such person's support. (Note: Josh's mother's gross income of \$2,000 is not too high in the current year for her to be claimed his dependent assuming all other requirements are met.) If he provides over one-half of her support, he also may deduct any medical expenses he pays on her behalf. Section 152 does not define "support." Regulation Sec. 1.152-1(a)(2) states that support includes "food, shelter, clothing, medical and dental care, education, and the like." It also provides that in determining the amount an individual contributes to his own support, one must count the cost of support items paid for from "income, which is ordinarily excludable from gross income, such as benefits received under the Social Security Act."

In Alfred H. Turecamo v. CIR, 39 AFTR 2d 77-1487, 77-1 USTC ¶9415 (2nd Cir., 1977), the court held that hospital costs paid by Basic Medicare do not constitute support the ill person furnishes for himself or herself. After studying the legislative history of the Medicare statute, the court could find no valid basis "for distinguishing between hospital benefits received under Part A of Medicare [Basic Medicare] and either private insurance proceeds or supplemental benefits received under Part B [of Medicare]."

In Rev. Rul. 70-341, 1970-2 C.B. 31, the IRS ruled that Basic Medicare payments on a person's behalf must be treated as contributions by such person toward his own support. Such treatment was in contrast to that of Supplemental Medicare, which the IRS viewed as in the nature of insurance proceeds, and not self-support. Revenue Ruling 64-223, 1964-2 C.B. 50, held that amounts paid by an insurance company for medical costs are disregarded in the support test.

In Rev. Rul. 79-173, 1979-1 C.B. 86, however, the IRS revoked Rev. Rul. 70-341. Thus, the IRS currently treats Basic Medicare payments consistently with Supplemental Medicare and ignores amounts received from either source for purposes of the support test. In Archer v. Comm. 73 T.C. 963 (1980), the court held that both Medicare and Medicaid are disregarded in the support test.

C:1-65 In determining whether the property is used "too much" for personal purposes so that Sec. 280A applies, use of the residence by Amy or by family members constitutes personal use, as does use by persons who pay less than fair rental value (Sec. 280A(d)(2)). Use by Amy when performing repairs and maintenance full-time is totally disregarded (Sec. 280A(d)(2)). For purposes of allocating the expenses attributable to rental use, however, all the days on which the property is rented for fair rental value are considered, even if the property is rented to family members on some of these days (Prop. Reg. Sec. 1.280A-3(c)).

The total number of days rented at fair rental value – the numerator of the fraction used in the allocation – is determined as follows:

Days rented to sister	8
Days rented to cousin	4
Days rented to three families	120
Total	132

The denominator for allocating interest and taxes is in dispute. Per Prop. Reg. Sec. 1.280 A-3(d)(3), the denominator is the total number of days of actual use (exclusive of use by the owner for performing repairs). Thus, the denominator would be 146 (12 + 8 + 4 + 2 + 120). Case law supports using as the denominator the number of days in the year, or 365 days in this case for allocating interest and taxes. Dorrance D. Bolton v. CIR 51 AFTR 2d 83-305, 82-2 USTC ¶9,699, (9th Cir., 1982), affirming 77 T.C. 104 (1981), and Edith G. McKinney v. CIR 52 AFTR 2d 83-6281, 83-2 USTC ¶9,665 (10th Cir., 1983).

For allocating repairs, insurance, and depreciation, this ratio is the number of days rented at fair rental value divided by the total number of days of actual use, or 132/148. However, there is a conflict between Sec. 280A(e) and Prop. Reg. §1.280A-3(d)(3). The proposed regulation excludes repair days from the denominator, but the IRC is silent. Excluding the repair days results in a denominator of 146.

C:1-66 a. The principal issue in both cases was whether the corporation could deduct amounts paid as compensation to the spouse (ex-spouse) of a sole shareholder. This issue, in turn, depended on whether such compensation was "reasonable" under the circumstances.

b. The Tax Court considered a number of factors, including (1) the employee's qualifications and training, (2) the nature, extent, and scope of her duties, (3) responsibilities and hours involved, (4) the size and complexity of the business, (5) the results of the employee's efforts, (6) the prevailing rates for comparable employees in comparable businesses, (7) the scarcity of other qualified employees, (8) the ratio of compensation to the gross and net income of the business, (9) the salary policy of the employer to other employees, and (10) the amount of compensation paid to the employee in prior years.

c. The facts of these cases are similar in the following respect: in both cases, the taxpayers were corporations that claimed a deduction for payments made to the spouse or ex-spouse of a sole shareholder. The facts are different in these respects: (1) In Summit the IRS contended that only a portion of the salary payments were nondeductible; in J.B.S., it argued that none of the salary payments were deductible. (2) In Summit, the spouse performed extensive services for the firm; in J.B.S., the ex-spouse appears to have performed no services. (3) In Summit, the court took into consideration the corporation's rising profits; in J.B.S., the court did not. (In fact, the latter opinion does not mention the firm's profits or loss position). (4) In Summit, the payments did not appear to be motivated by tax avoidance. (Because the corporation paid substantial dividends to its sole shareholder, the payments to the spouse did not appear to be "disguised dividends"). In J.B.S., the payments did appear to be motivated by tax avoidance. (Testimony indicated that some tax positions had been taken to minimize the corporation's tax liability).

C:1-67 The memorandum should supply the following answers:

a. Revenue Proc. 2021-1, 2021-1 I.R.B. 1 and Rev. Proc. 2021-4, 2021-1 I.R.B. 157 govern requests for determination letters.

b. Form 5300, "Application for Determination for Employee Benefit Plan," must be filed with the request.

c. The following information must be provided in the request:

1 Complete statement of facts and other information
2. Copies of all contracts, wills, deeds, agreements, instruments, other documents pertinent to the transaction, and foreign laws
3. Analysis of material facts
4. Statement regarding whether same issue is in an earlier return and additional information required for §301.9100 requests
5. Statement regarding whether same or similar issue was previously ruled on or whether a request involving it was submitted or is currently pending
6. Statement regarding interpretation of a substantive provision of an income or estate tax treaty
7. Statement regarding involvement of a transactional party located in a foreign country
8. Letter from Bureau of Indian Affairs relating to a letter ruling request for recognition of Indian tribal government status or status as a political subdivision of an Indian tribal government.
9. Statement of supporting authorities
10. Statement of contrary authorities

11. Statement identifying pending legislation
12. Statement identifying information to be deleted from the public inspection copy of letter ruling or determination letter
13. Signature by taxpayer or authorized representative
14. Authorized representatives
15. Power of attorney and declaration of representative
16. Penalties of perjury statement
17. Number of copies of request to be submitted
18. Sample format for a letter ruling request
19. Checklist for letter ruling requests

d. Actions that must accompany the filing include payment of appropriate user fee and notification of interested parties.

"What Would You Do In This Situation?" Solution

Ch. C:1, p. C:1-34.

In this context, you have two professional duties: first, a duty of confidentiality to each client, and second, a duty to verify information that appears to be incorrect on its face. According to Statement No. 3 of the Statements on Standards for Tax Services, a CPA who is required to sign a tax return should consider information actually known to the CPA from the tax return of another client if (1) that information is relevant to the former return, (2) its consideration is necessary to properly prepare that return, and (3) the use of such information does not violate any rule of confidentiality. Here, (1) the information relating to each return is relevant to the other; (2) its consideration is necessary to properly prepare the other return; and (3) the use of such information does not violate any rule of confidentiality, *so long as the information is not disclosed to the other client.* Your considering the tax return information should lead you to believe that it is incorrect on its face; therefore, you have a duty to verify it.

Accordingly, without revealing the basis for your belief, you should request from each client documentary evidence of its respective claim. Such evidence should consist of a paid invoice, a canceled check, a signed or certified receipt, a bill of lading, or any other document that indicates the essential terms of the contract of sale.

Chapter C:1

Tax Research

Learning Objectives

After studying this chapter, the student should be able to:

1. Distinguish between closed fact and open fact tax situations.

2. Describe the steps in the tax research process.

3. Explain how the facts influence tax consequences.

4. Identify the sources of tax law and assess the authoritative value of each.

5. Consult tax services to research an issue.

6. Apply the basics of Internet-based tax research.

7. Use a citator to assess tax authorities.

8. Describe professional guidelines that CPAs in tax practice should follow.

9. Prepare work papers and communicate to clients.

Areas of Greater Significance

Since this will usually be a student's first exposure to tax research, the importance of the facts to the tax results, federal tax services and the citator should be discussed. The widespread use of Internet-based databases for tax research makes this means of tax research much more important. An effort should be made to introduce Internet-based searches to the students if at all possible. The text discusses two types of professional guidelines for CPAs in tax practice.

Areas of Lesser Significance

In the interest of time, the following areas may be omitted:

Sample work papers and client letter (Appendix A).

Problem Areas for Students

The following areas may prove especially difficult to students:

1. Understanding how to use the tax services and citators.

2. Learning the authoritative value of each source of tax law.

Highlights of Recent Tax Law Changes

- For revenue rulings (and other IRS pronouncements) issued after 1999, the full four digits of the year of issuance are provided in the title. For revenue rulings and other pronouncements issued before 2000, only the last two digits of the year of issuance are provided in the title.

- Students should become familiar with the use of Internet-based databases which have replaced the paper services.

- For changes to the IRC enacted after July 29, 1996, the Treasury is generally precluded from issuing regulations with retroactive effect. In the case of final regulations, however, a regulation can be effective on the date proposed or the date on which temporary regulations are filed with the Federal Register. Regulations issued within 18 months of the date of a change to the statute can be issued with retroactive effect.

- Both CCH and RIA provide tax-related information via the Internet. The United States Tax Reporter is also available on LexisNexis and Westlaw.

Teaching Tips

- Example C:1-2: Use the example to emphasize to the students the importance of considering nontax objectives as well as tax objectives. p. C:1-2.

- Steps in the Tax Research Process, Paragraph 1: Walk through the steps in the tax research process. As you do this, emphasize to the students that the steps of the tax research process provide an excellent format for a written communication to a client or for a client file. You might consider going over the client communication contained in Appendix A.

- If proper citations are being stressed in the course, Table C:1-3 is a good reference.

- Illustrate to the students how to use the Internet version of one of the tax services or the LEXIS online service in an in-class demonstration.

Lecture Outline

I. Overview of Tax Research.

Tax research can be conducted in a number of different settings. Tax research involves solving a specific tax-related question using a number of tax law sources as they apply to a particular situation. Sample work papers demonstrating how to document the results of a research effort are included in Appendix A. In addition, the text discusses two types of professional guidelines for CPAs in tax practice: the AICPA's guidelines for CPAs in tax practice, the Statements on Standards for Tax Services and Treasury Department Circular 230 (reproduced in Appendix E).

A. Client-oriented research is conducted by accounting and law firms for the benefit of their clients. It involves determining the tax consequences of a certain transaction for a given client. It is performed in:

1. Closed-fact or tax compliance situations. (See Example C:1-1.) p. C:1-2.
2. Open-fact or tax-planning situations. (See Example C:1-2.) p. C:1-2.

B. **Academic settings.** Tax policy research may be conducted by individuals in an academic setting (e.g., accounting programs, law schools, economics departments, etc.).

The tax advisor should always bear in mind the financial accounting implications of proposed transactions. Though interrelated, the two fields of accounting have different orientations and different objectives. Tax accounting is oriented primarily to the Internal Revenue Service. Its objectives include calculating, reporting, and predicting one's tax liability according to legal principles. Financial accounting is oriented primarily to shareholders, creditors, managers, and employees. Its objectives include determining, reporting, and predicting a business's financial position and operating results according to Generally Accepted Accounting Principles.

II. Steps in the Tax Research Process.

When doing tax research in the context of tax planning or just in engaging in tax planning, the emphasis should be placed on the circular nature of the tax research process. It often requires the determination of different facts, restatement of the research question, or reliance on additional authorities. (Refer here to Figure C:1-1) p. C:1-4. There are, however, six basic steps to the tax research process:

A. Determine the facts.

B. Identify the issues (questions).

C. Locate the applicable authorities.

D. Evaluate the authorities and choose those to follow where the authorities conflict.

E. Analyze the facts in terms of the applicable authorities.

F. Communicate conclusions and recommendations to the client.

A professional needs to keep a number of points in mind.

A. The objective is not to minimize taxes per se but rather to maximize the after-tax return.

B. One does not engage in unilateral transactions; thus, the tax ramifications to all parties to the contract are relevant.

C. Taxes are but one cost of doing business.

D. The time for tax planning is not restricted to when one enters into an investment, contract, or other arrangement, but rather the time extends throughout the life of the activity.

Appendix A walks students through the research process.

Tax research often involves a "gray area;" that is, one that does not have a clear-cut, unequivocally correct solution. The issue should be pursued through the use of a specifically tailored set of detailed questions. Tax research may also involve determining which issues need to be researched. It requires a fairly extensive knowledge of tax law to be able to determine which issues need to be researched.

A tax advisor should always bear in mind the financial accounting implications of proposed transactions. An answer that may be desirable from a tax perspective may not always be desirable from a financial accounting perspective. Success in any tax practice, especially at the managerial level, requires consideration of both sets of objectives and orientations.

III. Importance of the Facts to the Tax Consequences.

The importance of a particular set of facts to the tax results should be emphasized. Three illustrations are presented for class discussion. These illustrations should naturally lead into a discussion of how a factual situation can be designed to meet the statutory requirements.

IV. The Sources of Tax Law.

The term "tax law" generally encompasses much more than just the tax statutes as enacted by Congress. The law contains very general language that requires interpretation, both administrative and judicial. Administrative interpretations include Treasury Regulations, revenue rulings, and revenue procedures. Judicial interpretations consist of court decisions. Tax law also consists of committee reports issued by Congress during the legislative process.

A. **Legislative Process.** All tax legislation must originate in the House of Representatives. Tax bills are referred to the House Ways and Means Committee. After a bill is approved by the House Ways and Means Committee, it moves to the floor of the House for consideration. If approved by a majority of the House, it moves to the Senate. After consideration by the Senate Finance Committee, it moves to the Senate floor for approval. Usually the House and Senate bills will not be in complete agreement. The bill will then go to a conference committee consisting of members of both houses. A compromise will then be made between the two versions of the tax bill. The compromise is then voted on by both houses of Congress and goes on to the President for his signature or veto. Both houses of Congress generally hold extensive hearings at which time interested parties are free to testify. The U.S. Government Printing Office publishes the statements made at hearings. Committee reports explaining Congress's purpose in drafting legislation are published by the U.S. Government Printing Office in the **Cumulative Bulletin**. Committee reports are particularly useful in interpreting the law prior to issuance of Treasury regulations. (See Example C:1-4.) p. C:1-8.

B. **Internal Revenue Code.** The Internal Revenue Code is the foundation of all tax law. It was first codified in 1939. Recodified in 1954, it has now been named the Internal Revenue Code of 1986. Whenever the law is changed, old language is deleted and new language is added.

C. **Treasury Regulations.** The Treasury Department issues Treasury Regulations as interpretations of the statute. They provide examples complete with computations to assist in understanding how IRC provisions are applied. Because statutory changes occur frequently, regulations are not always updated in a timely manner. When referring to a regulation, the tax advisor should consult the introductory note in order to determine when the regulation was adopted. Treasury Regulations are first provided in proposed form and the public has an opportunity to comment and suggest changes. Proposed regulations have no more authoritative weight than the position the IRS argues for in a brief, but provide guidance on the Treasury Department's interpretation of a statute. Temporary regulations (which generally are effective upon publication) are often issued soon after a major statutory change to provide guidance on procedural and computational matters. Temporary regulations have the same authoritative value as final regulations; however, they cannot remain temporary for more than a three-year period. Temporary regulations must be issued concurrently with proposed regulations. Final regulations are drafted after the public has had time to comment on the proposed regulations. Final regulations have the same authoritative weight as the statute and generally take effect retroactive to the effective date of the statutory language they interpret.

For changes to the IRC enacted after July 29, 1996, the Treasury is generally precluded from issuing regulations with retroactive effect. In the case of final regulations, however, a regulation can be effective on the date proposed or the date on which temporary regulations are filed with the Federal Register. Regulations issued within 18 months of the date of a change to the statute can be issued with retroactive effect.

Regulations may also be classified as either interpretative or legislative. Interpretative regulations are issued under the general authority of Sec. 7805 and make the statutory language easier to understand and apply. They provide illustrations about how to perform certain computations. Legislative regulations provide rules on highly technical matters where Congress has delegated the rulemaking to the Treasury Department (e.g., consolidated tax return issues). Both types of regulations have the same authoritative weight and will be overturned only in very limited cases such as when, in the Court's opinion, the regulations exceed the scope of power delegated to the Treasury Department, are contrary to the IRC, or are unreasonable.

Section 7805 provides that the Secretary of the Treasury has the right to prescribe regulations and to provide what extent they are to be applied retroactively. Occasionally, taxpayers can successfully argue that a regulation is invalid and, consequently, should not be followed. This will occur only if the courts find that the regulation is "unreasonable and plainly inconsistent with the revenue statutes." Some courts apply the **legislative reenactment doctrine**, which holds that regulations finalized many years earlier and not amended by Congress through changes to the statutory language have Congressional approval.

Regulations are cited as follows. Numbers before the decimal point indicate the general subject matter of the regulation. Numbers to the right of the decimal place refer to the IRC section being interpreted. Numbers to the right of that number indicate the number of the regulation. Temporary or proposed regulations are cited as Temp. Reg. Sec. or Prop. Reg. Sec. When providing a citation, the researcher should be as precise as possible. An example of this would be Reg. Sec. 1.165-5(I), Ex. 2(I), which refers to the first portion of Example 2 that is contained in the first portion of the fifth regulation interpreting Sec. 165. You may wish at this point to use the **Stop and Think** material, which illustrates the force of law certain regulations have. pp. C:1-10-C:1-11.

D. **Administrative Pronouncements.** There are a number of different means that the IRS uses for interpreting the statute. After referring to the IRC and Treasury Regulations, tax advisors are likely to refer next to IRS interpretations for further authority for answering a tax question.

1. **Revenue Rulings.** Revenue rulings are used to indicate the tax status of a specific transaction, which has wide taxpayer interest. They represent the viewpoint of the IRS and do not have as much authority as federal court

cases or regulations. Approximately one hundred rulings are issued each year. A taxpayer does not have to follow a ruling if there is sufficient authority for different treatment. An IRS agent is, however, bound by the rulings. Rulings are published weekly in the **Internal Revenue Bulletin** (I.R.B.) and semiannually in the **Cumulative Bulletin** (C.B.) prior to 2009. Refer now to p. C:1-12 to see how revenue rulings are cited.

2. **Revenue Procedures.** Revenue procedures usually deal with procedural aspects of tax practice. They are first published in the **Internal Revenue Bulletin** and later in the **Cumulative Bulletin** until 2009. Refer now to p. C:1-12 to illustrate how revenue procedures are cited. In addition to revenue rulings and revenue procedures, the *Cumulative Bulletin* contains IRS notices, as well as the texts of proposed regulations, tax treaties, committee reports, and U.S. Supreme Court decisions. For revenue rulings issued after 2008, the Internal Revenue Bulletin is the final reference.

3. **Letter Rulings.** Letter rulings are initiated by taxpayers who ask the IRS to explain the tax consequences of a particular transaction. The IRS responds in a letter ruling that can be relied on only by the person requesting it. They provide insight into the current thinking of the IRS. CCH publishes rulings with any confidential information deleted in a separate letter ruling service. Refer to pp. C:1-12-C:1-13 to illustrate how letter rulings are cited.

4. **Technical Advice Memoranda.** When a taxpayer's return is being audited with respect to a complicated, technical matter, the taxpayer may request that the matter be referred to the IRS National Office in Washington, D.C. concerning the appropriate tax treatment. The answer is issued in the form of a Technical Advice Memoranda, which is made available in the form of a letter ruling. Refer to p. C:1-13 to illustrate how technical advice memoranda are cited.

5. **Tax Information Releases.** Tax Information releases contain information about interpretations of general interest and are released to the news media throughout the United States. Refer now to p. C:1-13 to illustrate how information releases are cited.

6. **Announcements and Notices.** Information releases that are more technical and aimed at tax practitioners are issued in the form of Announcements. Announcements are often issued before temporary or proposed regulations can be issued. The IRS is bound by announcements and notices in the same way as if contained in a revenue ruling. Notices and announcements issued prior to 2009 appear in both the Internal Revenue Bulletin and the Cumulative Bulletin. As of 2009, they appear only in the Internal Revenue Bulletin. Refer now to p. C:1-13 to illustrate how announcements are cited.

E. **Judicial Decisions.** Judicial decisions comprise an important source of tax law. Judicial decisions in different jurisdictions are sometimes in conflict. See Figure C:1-1, p. C:1-15 for a summary of the court system.

Overview of the Court System. There are three trial courts - the U.S. Tax Court, the U.S. Court of Federal Claims, and the U.S. District Courts. Litigation may begin in any court, but precedent is an important factor in determining where it should begin. Cash flow also may be an important factor. Taxes must be paid before litigation begins in the U.S. Court of Federal Claims or the U.S. District Courts. After the taxes are paid, a claim for refund is filed, which will be denied by the IRS. A suit for refund is then brought and, if won, a refund with interest is obtained. A suit may be brought in the Tax Court. If lost, the deficiency plus any interest and penalties must be paid. The District Courts are the only place that a jury trial is possible. Decisions can be appealed from the Tax Court and the U.S. District Courts to the Court of Appeals in the taxpayer's circuit. Appeals from the U.S. Court of Federal Claims are taken to the Court of Appeals for the Federal Circuit. A party who loses at the appellate level can ask the Supreme Court for a **writ of certiorari**. The Supreme Court hears only about six to ten tax cases a year. (See Table C:1-1 Federal Judicial Circuits for a listing of states in the various Courts of Appeals on p. C:1-15.) (See Table C:1-2 for an overview of the court system on p. C:1-16.)

U.S. Tax Court. The U.S. Tax Court originated in 1942 as the successor to the Board of Tax Appeals. It is a court of national jurisdiction that hears only tax-related cases. All taxpayers, regardless of their state of residence, may litigate in the Tax Court. It has 19 judges, including one chief judge. The President, with the consent of the Senate, appoints the judges for a 15-year term and may reappoint them for an additional term. The judges, specialists in tax-related matters, periodically travel to roughly one hundred cities throughout the country to hear cases. In most instances, only one judge hears a case.

The Tax Court has a special policy in dealing with cases where the amount in question does not exceed $50,000 a year (i.e., small cases). Taxpayers can represent themselves without an attorney. The cases are heard by special commissioners instead of one of the Tax Court judges. Decisions under this procedure cannot be appealed.

The IRS has an **acquiescence policy** with regard to federal court decisions that have been decided in the taxpayer's favor. If it wishes to go on record that it agrees with a federal court decision, it acquiesces. If it wishes to disagree with a decision, it issues a nonacquiescence. This policy is not followed in all federal court decisions. An acquiescence or nonacquiescence is binding on an IRS agent. If a taxpayer is audited and has taken a position, in which the IRS has issued a nonacquiescence, litigation will likely be the only recourse for the taxpayer. IRS acquiescences and nonacquiescences are published in the Internal Revenue Bulletins and Cumulative Bulletins.

Regular decisions of the Tax Court are published by the U.S. Government Printing Office in a bound volume known as the **Tax Court of the United States Reports**. Soon after a decision is made public, it is also published by RIA and CCH in their loose-leaf reporters of Tax Court decisions. Refer now to Table C:1-3, p. C:1-22 to illustrate regular and memo Tax Court citations.

U.S. District Courts. Each state has a U.S. district court and more populous states have several district courts. Many different types of cases are heard by this court and a taxpayer may request a jury trial. District court decisions are officially reported in the **Federal Supplement** (F. Supp.) published by West. Tax decisions are also published by RIA in the **American Federal Tax Reports** (AFTR) and by CCH in the **U.S. Tax Cases** (USTC). Refer now to Table C:1-3, p. C:1-22 to illustrate a district court citation.

U.S. Court of Federal Claims. The U.S. Court of Federal Claims, as reorganized in 1982 and renamed in 1992, is a national court with decisions appealable to the Circuit Court of Appeals for the Federal Circuit. U.S. Court of Federal Claims decisions were published in the **Claims Court Reporter** by West Publishing Co. from 1982 to 1992. These cases are now reported in the **Federal Claims Reporter** (Fed. Cl.). In addition, the AFTR and USTC services report these tax decisions. Refer now to Table C:1-3, p. C:1-22 to illustrate this citation.

Circuit Courts of Appeal. Trial court decisions are appealable to a particular circuit court of appeals depending upon where the litigation originated. In the case of an individual, it depends upon the taxpayer's residence on the date of appeal. In the case of a corporation, it is the principal place of business that controls. There are 11 geographical circuits, the circuit for the District of Columbia and the Federal Circuit. (See Figure C:1-3, p. C:1-22.) New circuit court of appeals decisions are reported officially in the **Federal Reporter, Third Series** (F.3d) published by West. In addition, AFTR and USTC services report these decisions. Refer now to Table C:1-3, p. C:1-22 to illustrate this citation.

Supreme Court. A decision of an appellate court can be appealed to the U.S. Supreme Court. Unless the circuits are divided on the proper treatment of an issue or the issue is deemed of great significance, the Supreme Court will not grant **certiorari**. Decisions of the Supreme Court are the law of the land. If Congress does not agree with a Supreme Court decision, statutory language can be amended to reach the desired result. Supreme Court decisions are published in the **United States Supreme Court Reports** (U.S.) by the U.S. Government Printing Office, the **Supreme Court Reporter** (S.Ct.) by West, and the **United States Reports, Lawyers' Edition** (L.Ed.) by Lawyer's Co-Operative Publishing Co. In addition, the AFTR and USTC services report these tax decisions. Refer now to Table C:1-3, p. C:1-22 to illustrate this citation.

Precedential Value of Various Decisions.

1. The Tax Court will generally rule uniformly for taxpayers. It is bound by Supreme Court decisions. In 1970, the **Golsen** rule was adopted which mandates that the Tax Court will follow decisions of the court for the circuit to which a case in question is appealable.

2. U.S. district court decisions have precedential value only for subsequent cases heard in the same district. District courts must follow decisions of the Supreme Court and the court of appeals to which the case is appealable.

3. The U.S. Court of Federal Claims must rule consistently with the Supreme Court, Circuit Court of Appeals for the Federal Circuit, and its own earlier decisions.

4. A circuit court of appeals is bound by the Supreme Court and earlier decisions made by that circuit. *Green v.* US 185 F. 3d 67, 84 AFTR 2d 99-5415, 99-2 USTC ¶50,701 (3rd Cir, 1999).

   The Green Case appears on page 67, volume 185 of the *Federal Reporter, Third Series.* It is also published in volume 84, page 99-5415 on AFTR, Second Series, and in Volume 2, Paragraph 50,701 of the 199 USTC. The parenthetical information indicates that the Third Circuit decided the case in 1999 (*The Federal Reporter, Second Series* reference is found in footnote 33 of this chapter).

Because the courts are not always in agreement, a taxpayer can sometimes **forum shop** to select a court that is likely to be most favorable to the taxpayer's position. You may wish to use the **Stop and Think** materials at this point, which illustrate the importance of forum shopping. p. C:1-24.

F. **Tax Treaties.** The United States has treaties with a number of foreign countries. The treaties may pertain to tax and other matters. The provisions contained in a treaty in most cases override the rules contained in the IRC. p. C:1-24.

G. **Tax Periodicals.** Writings of tax experts in tax periodicals can provide useful insight into provisions contained in the IRC, Regulations, cases, or rulings. A list of periodicals is found on p. C:1-24. Published articles and tax service commentaries are secondary sources of authority. Primary sources of authority are the IRC and administrative and judicial interpretations. Only primary authorities should be cited.

V. Tax Services.

Organizationally, there are two types of tax services: first, “annotated,” and second, “topical.” An annotated tax service is organized by IRC section. The IRC-arranged subdivisions of this service are likely to encompass several topics. A topical tax service is organized by broad topic. The topically arranged subdivisions of this service are likely to encompass several IRC sections. The principal annotated tax services are United States Tax Reporter and Standard Federal Tax Reporter. The main topical services are Federal Tax Coordinator 2d and Tax Management Portfolios.

VI. The Internet as a Research Tool.

Internet databases are rapidly replacing books as the principal source of tax-related information. These databases encompass not only the IRC, Treasury Regulations, court cases, state laws, and other primary authorities, but also citators and secondary sources such as tax service reporters, treatises, journals, and newsletters. The principal advantages of using Internet-based tax services are ease and speed of access. The databases can be accessed using annotations or a “key word” approach. The annotated versions are arranged by IRC section. The annotations accompany editorial commentaries and include digests and summaries of IRS pronouncements and court opinions that interpret a particular IRC section. A topical tax service is organized by broad topic, including income taxes, estate and gift taxes, and excise taxes. The topically arranged sub-divisions of this service are likely to encompass several IRC sections. Each database is updated on a timely basis. See Table C:1-4 on p. C:1-25 for a summary of the key features of tax services.

The most widely used Internet-based research services are RIA’s Checkpoint™ (hereafter CHECKPOINT), accessible at http://checkpoint.riag.com, and the CCH Tax Research NetWork™ (hereafter CCH NETWORK), accessible at http://tax.cchgroup.com/network. Both services are updated continuously and store information in databases (called libraries). This chapter and the textbook discuss Internet-based tax services in general and focus on CHECKPOINT for illustrative purposes, but they all work in a similar manner.

VII. Citators.

Citators serve two functions: (1) they provide a history of the case; and (2) they list other authorities that have cited the case. The citator allows the user to input the names of specific case citations, and see all related pronouncements and status changes.

VIII. Professional Guidelines for Tax Services.

Professional guidelines for tax services are contained in both government-imposed and professional-imposed tax standards. Circular 230 sets forth rules to practice before the Internal Revenue Service and pertains to certified public accountants, attorneys, enrolled agents, and other persons representing taxpayers before the IRS. It presents duties and restrictions relating to such practice and prescribes sanctions and disciplinary proceedings for violating these regulations. Circular 230 also provides guidelines for written advice to taxpayers. In June 2014, these guidelines were significantly revised and eliminated the distinction between covered opinions and written advice. All rules are now governed under what is referred to as a “reasonable practitioner standard.” In the case of written advice, the practitioner is now supposed to base advice under reasonable assumptions and consider the facts that are important and not base an opinion on the probability of audit.

Statements on Standards for Tax Services (SSTS), issued by the American Institute of Certified Public Accountants and reproduced in Appendix E, set forth guidelines governing ethical issues in tax practice. Although the SSTSs are not legally enforceable, they carry significant moral weight, and may be cited in a negligence lawsuit as the proper “standard of care” for tax practitioners. They also provide grounds for the termination or suspension of one’s professional license. The Standards provide an ethical framework to govern the normative relationship between a tax advisor and his or her client, where, unlike an auditor, a tax advisor acts as the client’s advocate.

Page C:1-33 references how Cornell offers free access to many resources. This should be emphasized to students, specifically if they do not have college library access to the professional databases referenced within the chapter.

IX. Sample Work Papers.

Appendix A presents a set of sample work papers, including a draft of a client letter and a memo to the file. The work papers indicate the issues to be researched, the authorities addressing the issues, and the researcher’s conclusions concerning the appropriate tax treatment, with rationale for its use. Formats differ from firm to firm. The sample offers general guidance concerning the content of work papers.

Court Case Briefs

The following court cases illustrate how the courts, through judicially enunciated doctrines, impact the interpretation of tax law.

Hirotoshi Yamamoto v. CIR, 73 T.C. 946 (1980), aff'd. in unpublished opinion 672 F.2d 924 (9th Cir., 1982).

Yamamoto (Y) owned 100% of the stock of P Corporation. P Corporation owned 100% of the stock of subsidiary S. S was heavily indebted to P. During 1970 and 1971, S made loans to Y. Y transferred real property to S, those transactions being recorded as sales, in exchange for cash, release of Y's indebtedness to S and assumption of Y's liabilities by S. Subsequently, S transferred this property to P at a price equal to S's book value in the property. Additionally, Y purchased stock of P in exchange for cash.

Y argued that the step-transaction theory should apply to these transactions so they should be collapsed into one transaction and qualify for tax-free treatment under IRC Sec. 351. The court rejected this argument, stating that the rules for transfers to a controlled corporation did not apply because the property transfers and stock transfer had separate legal significance. The facts were consistent with this decision. This case involves a detailed analysis of the substance over form issue.

Evelyn F. Gregory v. Helvering, 293 U.S. 465 (1935).

Mrs. Gregory owned all of the stock of a corporation, which owned 1,000 shares of stock of another corporation. To get these shares and to obtain more favorable tax treatment, a new corporation was organized and the 1,000 shares of stock were transferred to it by the old corporation in what was claimed to be a nontaxable reorganization. The new corporation then dissolved and distributed its only asset, the shares of stock, to its sole shareholder, Mrs. Gregory. Mrs. Gregory then sold the stock and reported capital gains tax treatment on the sale. The Supreme Court held that a nontaxable reorganization had not occurred since the new corporation had no relation to the business of the old corporation and was formed solely as part of a preconceived plan with no business purpose. Tax avoidance was held not to be a sufficient business purpose to permit a tax-free reorganization to occur.

Chapter I:1

An Introduction to Taxation

Learning Objectives

After studying this chapter, the student should be able to:

1. Discuss the history of taxation in the United States.
2. Describe the three types of tax rate structures.
3. Describe the various types of taxes.
4. Discuss the criteria for a "good" tax structure, the objectives of the federal income tax law, and recent tax reform proposals.
5. Describe the tax entities in the federal income tax system.
6. Identify the various tax law sources and understand their implications for tax practice.
7. Describe the legislative process for the enactment of the tax law.
8. Describe the administrative procedures under the tax law.
9. Describe the components of a tax practice.
10. Understand the importance of computer applications in taxation.

Areas of Greater Significance

1. For an introductory course in taxation, two of the topics in this chapter should be emphasized. The first topic to be emphasized is the sources of tax law (both primary and secondary). The student should understand that in spite of the black and white rule approach in much of the following material, a tax practitioner may spend a considerable amount of time dealing with issues that are not clear cut.
2. Second, the administration of the tax law should be emphasized. An understanding of how the Internal Revenue Service operates is valuable to each student, even if the only future application is with regard to the student's own individual tax return.

Areas of Lesser Significance

In the interest of time, the instructor may determine that the following areas are best covered by student reading, rather than class discussion:

1. History of Taxation in the United States
2. Other Types of Taxes
3. Criteria for a Tax Structure
4. Objectives of the Federal Income Tax Law

Problem Areas for Students

The following areas may prove especially difficult for students:

1. The relative weight to be given to various governmental interpretations of the tax law (i.e., Treasury Regulations vs. Tax Court cases).
2. The mechanics and thought process in doing tax research. An instructor who will use tax research as a significant pedagogical tool may want to spend considerable time on the topic at this point. It is very difficult for a student to understand tax research without doing tax research. (See Chapter I:15.)

Highlights of Recent Tax Law Changes

The following items of tax law have changed since the 2021 edition of this chapter:

1. The income levels for tax rates for ordinary income, long-term capital gains, dividend income, and the kiddie tax have increased. (See Quick Reference.)
2. The ceiling amount for paying the full amount of payroll taxes has increased to $142,800 ($137,700 in 2020).
3. The unified transfer tax equivalent has increased to $11,700,000 ($11,580,000 in 2020).
4. The standard deduction has increased to $12,550 ($12,400 in 2020) and $25,100 for married filing jointly ($24,800 for 2020).
5. The beginning of the 37% tax bracket for taxable income from trusts has increased to $13,050 ($12,950 in 2020).

Teaching Tips

1. If you want to teach tax research in the introductory class, it would be best to assign a comprehensive tax research problem to solidify concepts taught in class.

2. When teaching tax law sources, it is important to clarify to the students the relative priority of the many different sources.

Lecture Outline

I. Types of Tax Rate Structures

1. The Structure of Individual Income Tax Rates (Example I:1-1, I:1-2)

    a. Possible tax rate structures are progressive, proportional (flat tax), or regressive. The current federal tax system is progressive (10%-37%).

2. Corporate Tax Rates

    a. The tax rate for regular corporations (C corporations) is flat (21%).

3. Marginal, Average, and Effective Tax Rates for Taxpayers (Example I:1-4, I:1-5)

    a. Marginal tax rates may vary significantly from the nominal schedule rates. For example, even though the nominal maximum individual rate is 37%, the realized marginal rate is higher because of health care taxes.

    b. Because the federal income tax for individuals is progressive, average tax is always below marginal tax.

    c. Effective tax rates are likely the lowest of the three calculations because economic income exceeds taxable income.

4. Determination of Taxable Income and Tax Due

    a. Taxable income for all types of taxpayers is calculated by subtracting allowable exclusions and deductions from total income. The tax or refund due is calculated by subtracting allowable credits and/or prepayments from the gross tax liability resulting from applying applicable tax rates to taxable income.

II. Entities in the Federal Income Tax System

1. Taxpaying entities are individuals (Example I:1-13) and C corporations (Example I:1-14). If trusts and estates do not fully distribute their taxable income, they may pay tax.

2. Flow-through entities are sole proprietorships, partnerships (Example I:1-18), S corporations, limited liability companies and limited liability partnerships, and trusts and estates (to the extent that the trust's or estate's income is distributed) (Example I:1-23).

III. Tax Law Sources (Topic Review I:1-3; Instructor Aid I:1-1)

1. Legislative tax law sources include the Internal Revenue Code and Congressional Committee Reports.

2. Executive (Administrative) tax law sources include proposed, temporary, and final Treasury regulations and IRS revenue rulings, revenue procedures, private letter rulings, technical advice memoranda, and information releases.

3. Judicial tax law sources include various levels of court decisions.

IV. Enactment of a Tax Law (Table I:1-2)

1. The procedures for enactment of tax legislation are the same as those for any other federal legislation, with the exception that all revenue measures are constitutionally required to be introduced in the House of Representatives. These procedures include deliberations by the House Ways and Means Committee, the Senate Finance Committee, and the Joint Conference Committee. The committee reports produced during these deliberations are valuable sources of legislative intent used in governmental and taxpayer interpretation of the enacted legislation.

2. The political process affects tax legislation as it proceeds through the House of Representatives and the Senate toward the President's signature. The economic, social, and revenue priorities of the legislators (and their constituencies) affect the final product. Also, efforts to reduce the budget deficit in recent years have had an impact on annual tax legislation.

V. Administration of the Tax Law and Tax Practice Issues (Instructor Aid I:1-2)

1. Organization of the Internal Revenue Service

   a. Important personnel in the IRS (in descending authority) are the Commissioner of the Internal Revenue, deputy and assistant commissioners, regional commissioners, and district directors.

b. Unresolved disputes between taxpayers and the IRS may result in litigation. Tax litigation in Tax Court is handled by the office of the Chief Counsel. Tax litigation in a U.S. District Court and the U.S. Claims Court is handled by attorneys in the Department of Justice.

2. Selection of Returns for Audit (Example I:1-25; Question I:1-29)

   a. With the use of computer analysis and professional judgment, taxpayer returns are selected for additional correspondence, office audit, or field audit. Mathematical errors and certain matching problems (e.g., the amount of interest on a Form 1099 received by the IRS does not match the amount of interest reported by the taxpayer) can generally be resolved by correspondence.

   b. In an office audit, the taxpayer is asked to bring documentation to the IRS office to substantiate income, deduction, and/or credit items on the taxpayer's return. More complex audits are handled by a field audit where the IRS agent goes to the taxpayer's place of business or to the office of the taxpayer's tax professional.

   c. Disputes between IRS agents and taxpayers may be resolved with the IRS Appeals Division. While the overall individual audit rate is less than 1%, individuals with relatively large amounts of income and deductions are significantly more likely to be audited. If a return contains a frequently disputed item (e.g., home office deduction), the likelihood of audit also increases.

3. Statute of Limitations (Problem I:1-48)

   a. The normal statute of limitations (i.e., how long the IRS has to examine the return) is three years from the due date of the return (or when the return is actually filed if late). The statute of limitations is extended to six years if more than 25% of gross income is omitted on the return. There is no statute of limitations if the taxpayer committed fraud or failed to file a return.

   b. The applicable statute of limitations may be extended by mutual agreement between the taxpayer and the government. Reticent taxpayers are encouraged to extend the statute of limitations when the alternative is an immediate unfavorable notice of deficiency. These varying lengths of statutes of limitation also cause a record-keeping problem for taxpayers. How can a taxpayer disprove an IRS claim of fraud without keeping tax records indefinitely?

4. Interest and Penalties (Example I:1-27)

   a. Interest and penalties may apply to taxes due and other taxpayer noncompliance. The deductibility of interest paid will be determined under the normal interest deductions rules. Penalties for failure to file, failure to pay, negligence, fraud, etc., are not tax deductible.

VI. Components of a Tax Practice

1. Tax Compliance and Procedures

   a. The preparation of tax returns remains a major component of most tax practices. Some major firms have a separate department to deal with tax compliance.

2. Tax Research

   a. The tax research process involves determination of the facts, identification of the problem, determination of the best solution and communication to the client. (See Chapter I:15 for an in-depth discussion of tax research.)

3. Tax Planning and Consulting

   a. Much of the tax professional's value to a client may be in the planning and consulting areas. Minimizing taxes paid and maximizing after-tax cash flows, while accommodating clients' desires, is a much sought-after commodity in today's complex tax environment.

4. Financial Planning

   a. Some tax professionals have added financial planning to their list of services offered. Items analyzed include insurance coverage, investment strategies, and retirement planning.

Court Case Briefs

Alfred Ficalora v. CIR, 55 AFTR 2d 85-473, 85-1 USTC & 9103 (2nd Cir., 1984).

In 1980, an employee of the New York telephone company challenged the constitutional authority of Congress and the Tax Court to impose a direct tax on his wages without apportionment to the States. He cited Article I, Section 9, clause 4 of the U.S. Constitution which prohibits a direct tax without apportionment. The taxpayer further relied on the case of _Pollock v. Farmer's Loan and Trust Co._, 3 AFTR 2602, 15 S. Ct. 912 (USSC, 1895) which states that a tax on the income from real and personal property was invalid without apportionment.

The Supreme Court in _Pollock_, however, had stated explicitly that a tax on one's employment was not a direct tax and did not require apportionment. Further, the Sixteenth Amendment to the U.S. Constitution gave Congress the authority to tax income without apportionment. The court found that the taxpayer had ignored the developments in Constitutional law over the last ninety years and upheld the deficiency and penalties assessed against him.

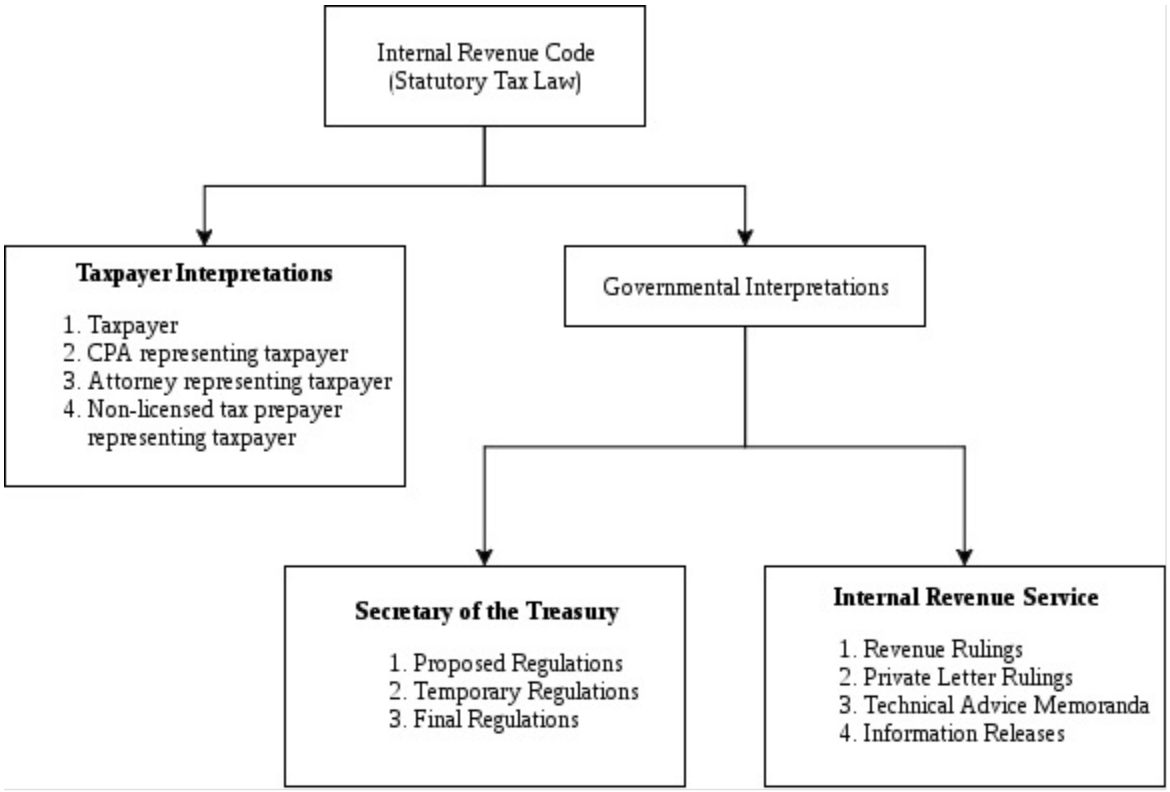
Walter G. Pietsch v. CIR, 26 AFTR 2d 70-5847, 70-2 USTC & 9718 (2nd Cir., 1970).

Mr. Pietsch filed his 1968 income tax return, but denied liability for the portion of the tax that was associated with funding the military operation of the United States in the Vietnam conflict. The taxpayer sought a declaration from the court that American participation in Vietnam was unconstitutional and asked the court to enjoin the federal officials from collecting the tax.

The suit was dismissed for failure to state a claim (the taxpayer had not yet paid the tax). The court stated further that Mr. Pietsch was most unlikely to prevail in a refund suit (commenced after the tax was paid) because he did not attack the validity of the tax itself, but rather the use of it.

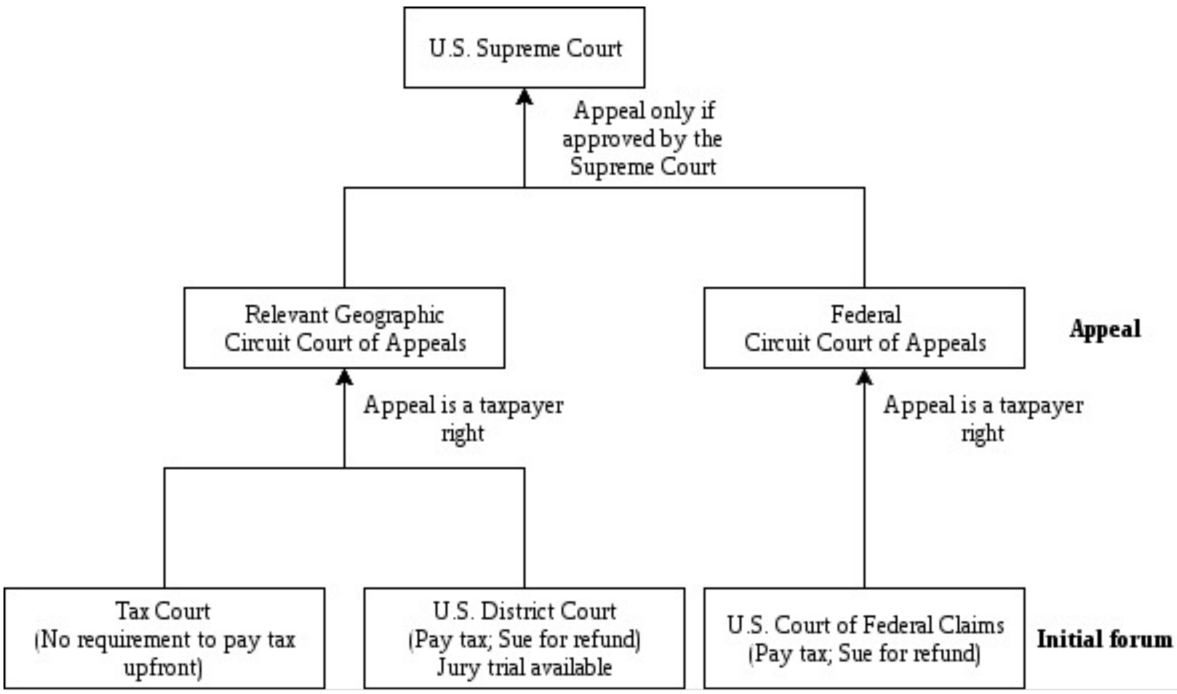
Instructor Aid I:1-1

Tax Law Interpretations



Instructor Aid I:1-2

Tax Litigation from the Taxpayer Perspective



Form **1040** Department of the Treasury—Internal Revenue Service (99)
U.S. Individual Income Tax Return **2020** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

Filing Status Check only one box. ☐ Single ☑ Married filing jointly ☐ Married filing separately (MFS) ☐ Head of household (HOH) ☐ Qualifying widow(er) (QW)
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent ▶

Your first name and middle initial	Last name	Your social security number
Zachary L.	Mao	123 45 6789
If joint return, spouse's first name and middle initial	Last name	Spouse's social security number
Cici K.	Mao	987 65 4321

Home address (number and street). If you have a P.O. box, see instructions. 520 Chestnut St. Apt. no.
City, town, or post office. If you have a foreign address, also complete spaces below. Philadelphia State PA ZIP code 19106
Foreign country name Foreign province/state/county Foreign postal code

Presidential Election Campaign Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse

At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? ☐ Yes ☑ No

Standard Deduction **Someone can claim:** ☐ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness **You:** ☐ Were born before January 2, 1956 ☐ Are blind **Spouse:** ☐ Was born before January 2, 1956 ☐ Is blind

Dependents (see instructions): If more than four dependents, see instructions and check here ▶ ☐

(1) First name	Last name	(2) Social security number	(3) Relationship to you	(4) ✔ if qualifies for (see instructions): Child tax credit	Credit for other dependents
Oliver	Mao	111 22 3333	Son	☑	☐
				☐	☐
				☐	☐
				☐	☐

Attach Sch. B if required.

1	Wages, salaries, tips, etc. Attach Form(s) W-2		1	85,000
2a	Tax-exempt interest	b Taxable interest	2b	200
3a	Qualified dividends	b Ordinary dividends	3b	
4a	IRA distributions	b Taxable amount	4b	
5a	Pensions and annuities	b Taxable amount	5b	
6a	Social security benefits	b Taxable amount	6b	
7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐		7	
8	Other income from Schedule 1, line 9		8	
9	Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income** ▶		9	85,200
10	Adjustments to income:			
a	From Schedule 1, line 22	10a		
b	Charitable contributions if you take the standard deduction. See instructions	10b		
c	Add lines 10a and 10b. These are your **total adjustments to income** ▶		10c	
11	Subtract line 10c from line 9. This is your **adjusted gross income** ▶		11	85,200
12	**Standard deduction or itemized deductions** (from Schedule A)		12	24,800
13	Qualified business income deduction. Attach Form 8995 or Form 8995-A		13	
14	Add lines 12 and 13		14	24,800
15	**Taxable income.** Subtract line 14 from line 11. If zero or less, enter -0-		15	60,400

Standard Deduction for—
- Single or Married filing separately, $12,400
- Married filing jointly or Qualifying widow(er), $24,800
- Head of household, $18,650
- If you checked any box under *Standard Deduction,* see instructions.

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2020)

16	**Tax** (see instructions). Check if any from Form(s): 1 ☐ 8814 2 ☐ 4972 3 ☐ ______			16	6,856*
17	Amount from Schedule 2, line 3			17	
18	Add lines 16 and 17			18	6,856
19	Child tax credit or credit for other dependents			19	2,000
20	Amount from Schedule 3, line 7			20	
21	Add lines 19 and 20			21	2,000
22	Subtract line 21 from line 18. If zero or less, enter -0-			22	4,856
23	Other taxes, including self-employment tax, from Schedule 2, line 10			23	
24	Add lines 22 and 23. This is your **total tax** ▶			24	4,856
25	Federal income tax withheld from:				
a	Form(s) W-2	25a	5,600		
b	Form(s) 1099	25b			
c	Other forms (see instructions)	25c			
d	Add lines 25a through 25c			25d	5,600
26	2020 estimated tax payments and amount applied from 2019 return			26	
27	Earned income credit (EIC)	27			
28	Additional child tax credit. Attach Schedule 8812	28			
29	American opportunity credit from Form 8863, line 8	29			
30	Recovery rebate credit. See instructions	30			
31	Amount from Schedule 3, line 13	31			
32	Add lines 27 through 31. These are your **total other payments and refundable credits** ▶			32	
33	Add lines 25d, 26, and 32. These are your **total payments** ▶			33	5,600

• If you have a qualifying child, attach Sch. EIC.
• If you have nontaxable combat pay, see instructions.

Refund

34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you **overpaid**			34	744
35a	Amount of line 34 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐			35a	744
▶ b	Routing number ▶ c Type: ☐ Checking ☐ Savings				
▶ d	Account number				
36	Amount of line 34 you want **applied to your 2021 estimated tax** ▶	36			

Direct deposit? See instructions.

Amount You Owe

For details on how to pay, see instructions.

37	Subtract line 33 from line 24. This is the **amount you owe now** ▶			37	
	Note: Schedule H and Schedule SE filers, line 37 may not represent all of the taxes you owe for 2020. See Schedule 3, line 12e, and its instructions for details.				
38	Estimated tax penalty (see instructions) ▶	38			

Third Party Designee

Do you want to allow another person to discuss this return with the IRS? See instructions ▶ ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.) ▶
		Manager	
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.) ▶
		Teacher	
Phone no.	Email address		

Paid Preparer Use Only

Preparer's name	Preparer's signature	Date	PTIN	Check if: ☐ Self-employed
Firm's name ▶				Phone no.
Firm's address ▶				Firm's EIN ▶

Go to *www.irs.gov/Form1040* for instructions and the latest information. Form **1040** (2020)

*From 2020 Tax Table.

Form **1040-SR** Department of the Treasury—Internal Revenue Service (99) **U.S. Tax Return for Seniors** **2020** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

Filing Status* Check only one box.
☑ Single ☐ Married filing jointly ☐ Married filing separately (MFS)
☐ Head of household (HOH) ☐ Qualifying widow(er) (QW)
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent ▶

Your first name and middle initial	Last name	Your social security number
John R.	Lane	111 44 6666
If joint return, spouse's first name and middle initial	Last name	Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions.	Apt. no.	
1010 Ipsen St.		
City, town, or post office. If you have a foreign address, also complete spaces below.	State	ZIP code
Yorba Linda	CA	90102
Foreign country name	Foreign province/state/county	Foreign postal code

Presidential Election Campaign Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☑ You ☐ Spouse

At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? ▶ ☐ Yes ☑ No

Standard Deduction **Someone can claim:** ☐ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness **You:** ☑ Were born before January 2, 1956 ☐ Are blind
Spouse: ☐ Was born before January 2, 1956 ☐ Is blind

Dependents* (see instructions): If more than four dependents, see instructions and check here ▶ ☐

(1) First name Last name	(2) Social security number	(3) Relationship to you	(4) ✔ if qualifies for (see instructions): Child tax credit	Credit for other dependents
			☐	☐
			☐	☐
			☐	☐
			☐	☐

Attach Schedule B if required.

1	Wages, salaries, tips, etc. Attach Form(s) W-2				1	50,000
2a	Tax-exempt interest	2a		b Taxable interest	2b	240
3a	Qualified dividends	3a		b Ordinary dividends	3b	
4a	IRA distributions	4a		b Taxable amount	4b	
5a	Pensions and annuities	5a	41,000	b Taxable amount	5b	41,000
6a	Social security benefits	6a		b Taxable amount	6b	
7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐				7	
8	Other income from Schedule 1, line 9				8	
9	Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income** ▶				9	91,240
10	Adjustments to income:					
a	From Schedule 1, line 22	10a	6,000			
b	Charitable contributions if you take the standard deduction. See instructions	10b				
c	Add lines 10a and 10b. These are your **total adjustments to income** ▶				10c	6,000
11	Subtract line 10c from line 9. This is your **adjusted gross income** ▶				11	85,240

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 71930F Form **1040-SR** (2020)

*John does not qualify as a head of household because his cousin is not his dependent (his cousin fails the relationship test for a qualifying child, as well as the relationship test for a qualifying individual).

Standard Deduction
See *Standard Deduction Chart* on the last page of this form.

12	**Standard deduction or itemized deductions** (from Schedule A)		12	14,050*
13	Qualified business income deduction. Attach Form 8995 or Form 8995-A		13	
14	Add lines 12 and 13		14	14,050
15	**Taxable income.** Subtract line 14 from line 11. If zero or less, enter -0-		15	71,190
16	**Tax** (see instructions). Check if any from: 1 ☐ Form(s) 8814 2 ☐ Form 4972 3 ☐ ______		16	11,449**
17	Amount from Schedule 2, line 3		17	
18	Add lines 16 and 17		18	11,449
19	Child tax credit or credit for other dependents		19	
20	Amount from Schedule 3, line 7		20	
21	Add lines 19 and 20		21	
22	Subtract line 21 from line 18. If zero or less, enter -0-		22	11,449
23	Other taxes, including self-employment tax, from Schedule 2, line 10		23	
24	Add lines 22 and 23. This is your **total tax** ▶		24	11,449
25	Federal income tax withheld from:			
a	Form(s) W-2	25a 12,100		
b	Form(s) 1099	25b		
c	Other forms (see instructions)	25c		
d	Add lines 25a through 25c		25d	12,100
26	2020 estimated tax payments and amount applied from 2019 return		26	
27	Earned income credit (EIC)	27		
28	Additional child tax credit. Attach Schedule 8812	28		
29	American opportunity credit from Form 8863, line 8	29		
30	Recovery rebate credit. See instructions	30		
31	Amount from Schedule 3, line 13	31		
32	Add lines 27 through 31. These are your **total other payments and refundable credits** ▶		32	
33	Add lines 25d, 26, and 32. These are your **total payments** ▶		33	12,100

• If you have a qualifying child, attach Sch. EIC.
• If you have nontaxable combat pay, see instructions.

Go to *www.irs.gov/Form1040SR* for instructions and the latest information. Form **1040-SR** (2020)

* From Standard Deduction Chart on page 4 of Form 1040-SR.
** From 2020 Tax Table.

Refund	34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you **overpaid**	34	651
	35a	Amount of line 34 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐	35a	651
Direct deposit? See instructions.	▶ b	Routing number ▶ c Type: ☐ Checking ☐ Savings		
	▶ d	Account number		
	36	Amount of line 34 you want **applied to your 2021 estimated tax** ▶ 36		
Amount You Owe For details on how to pay, see instructions.	37	Subtract line 33 from line 24. This is the **amount you owe now** ▶	37	
		Note: Schedule H and Schedule SE filers, line 37 may not represent all of the taxes you owe for 2020. See Schedule 3, line 12e, and its instructions for details.		
	38	Estimated tax penalty (see instructions) ▶ 38		

Third Party Designee

Do you want to allow another person to discuss this return with the IRS? See instructions ▶ ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.)
		Retired	
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.)
Phone no.	Email address		

Paid Preparer Use Only

Preparer's name	Preparer's signature	Date	PTIN	Check if: ☐ Self-employed
Firm's name ▶			Phone no.	
Firm's address ▶			Firm's EIN ▶	

Go to *www.irs.gov/Form1040SR* for instructions and the latest information. Form **1040-SR** (2020)

Standard Deduction Chart*

Add the number of boxes checked in the "Age/Blindness" section of *Standard Deduction* on page 1 . . . . . ▶ 1*

IF your filing status is. . .	AND the number of boxes checked is. . .	THEN your standard deduction is. . .
Single	1	$14,050
	2	15,700
Married filing jointly	1	$26,100
	2	27,400
	3	28,700
	4	30,000
Qualifying widow(er)	1	$26,100
	2	27,400
Head of household	1	$20,300
	2	21,950
Married filing separately**	1	$13,700
	2	15,000
	3	16,300
	4	17,600

* Don't use this chart if someone can claim you (or your spouse if filing jointly) as a dependent, your spouse itemizes on a separate return, or you were a dual-status alien. Instead, see instructions.

** You can check the boxes for your spouse if your filing status is married filing separately and your spouse had no income, isn't filing a return, and can't be claimed as a dependent on another person's return.

SCHEDULE 1
(Form 1040)

Department of the Treasury
Internal Revenue Service

Additional Income and Adjustments to Income

▶ **Attach to Form 1040, 1040-SR, or 1040-NR.**
▶ **Go to *www.irs.gov/Form1040* for instructions and the latest information.**

OMB No. 1545-0074
2020
Attachment Sequence No. **01**

Name(s) shown on Form 1040, 1040-SR, or 1040-NR	**Your social security number**
John R. Lane	111-44-6666

Part I Additional Income

1	Taxable refunds, credits, or offsets of state and local income taxes	**1**	
2a	Alimony received	**2a**	
b	Date of original divorce or separation agreement (see instructions) ▶		
3	Business income or (loss). Attach Schedule C	**3**	
4	Other gains or (losses). Attach Form 4797	**4**	
5	Rental real estate, royalties, partnerships, S corporations, trusts, etc. Attach Schedule E	**5**	
6	Farm income or (loss). Attach Schedule F	**6**	
7	Unemployment compensation	**7**	
8	Other income. List type and amount ▶	**8**	
9	Combine lines 1 through 8. Enter here and on Form 1040, 1040-SR, or 1040-NR, line 8	**9**	

Part II Adjustments to Income

10	Educator expenses	**10**	
11	Certain business expenses of reservists, performing artists, and fee-basis government officials. Attach Form 2106	**11**	
12	Health savings account deduction. Attach Form 8889	**12**	
13	Moving expenses for members of the Armed Forces. Attach Form 3903	**13**	
14	Deductible part of self-employment tax. Attach Schedule SE	**14**	
15	Self-employed SEP, SIMPLE, and qualified plans	**15**	
16	Self-employed health insurance deduction	**16**	
17	Penalty on early withdrawal of savings	**17**	
18a	Alimony paid	**18a**	
b	Recipient's SSN ▶		
c	Date of original divorce or separation agreement (see instructions) ▶		
19	IRA deduction	**19**	6,000
20	Student loan interest deduction	**20**	
21	Tuition and fees deduction. Attach Form 8917	**21**	
22	Add lines 10 through 21. These are your **adjustments to income.** Enter here and on Form 1040, 1040-SR, or 1040-NR, line 10a	**22**	6,000

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 71479F **Schedule 1 (Form 1040) 2020**

CLICK HERE TO ACCESS THE COMPLETE Solutions

Form **1040** Department of the Treasury—Internal Revenue Service (99)
U.S. Individual Income Tax Return **2020** OMB No. 1545-0074 IRS Use Only—Do not write or staple in this space.

Filing Status Check only one box. ☑ Single ☐ Married filing jointly ☐ Married filing separately (MFS) ☐ Head of household (HOH) ☐ Qualifying widow(er) (QW)
If you checked the MFS box, enter the name of your spouse. If you checked the HOH or QW box, enter the child's name if the qualifying person is a child but not your dependent ▶

Your first name and middle initial	Last name	Your social security number
Tracy M.	Kidwell	433 33 3333
If joint return, spouse's first name and middle initial	Last name	Spouse's social security number

Home address (number and street). If you have a P.O. box, see instructions.	Apt. no.	Presidential Election Campaign
600 S. Maestri Place		Check here if you, or your spouse if filing jointly, want $3 to go to this fund. Checking a box below will not change your tax or refund. ☐ You ☐ Spouse

City, town, or post office. If you have a foreign address, also complete spaces below.	State	ZIP code
New Orleans	LA	70130
Foreign country name	Foreign province/state/county	Foreign postal code

At any time during 2020, did you receive, sell, send, exchange, or otherwise acquire any financial interest in any virtual currency? ☐ Yes ☑ No

Standard Deduction **Someone can claim:** ☑ You as a dependent ☐ Your spouse as a dependent
☐ Spouse itemizes on a separate return or you were a dual-status alien

Age/Blindness **You:** ☐ Were born before January 2, 1956 ☐ Are blind **Spouse:** ☐ Was born before January 2, 1956 ☐ Is blind

Dependents (see instructions): If more than four dependents, see instructions and check here ▶ ☐

(1) First name Last name	(2) Social security number	(3) Relationship to you	(4) ✔ if qualifies for (see instructions): Child tax credit	Credit for other dependents
			☐	☐
			☐	☐
			☐	☐
			☐	☐

Attach Sch. B if required.

1	Wages, salaries, tips, etc. Attach Form(s) W-2			1	
2a	Tax-exempt interest	2a	b Taxable interest	2b	9,000
3a	Qualified dividends	3a	b Ordinary dividends	3b	
4a	IRA distributions	4a	b Taxable amount	4b	
5a	Pensions and annuities	5a	b Taxable amount	5b	
6a	Social security benefits	6a	b Taxable amount	6b	
7	Capital gain or (loss). Attach Schedule D if required. If not required, check here ▶ ☐			7	
8	Other income from Schedule 1, line 9			8	
9	Add lines 1, 2b, 3b, 4b, 5b, 6b, 7, and 8. This is your **total income** ▶			9	9,000
10	Adjustments to income:				
a	From Schedule 1, line 22	10a			
b	Charitable contributions if you take the standard deduction. See instructions	10b			
c	Add lines 10a and 10b. These are your **total adjustments to income** ▶			10c	
11	Subtract line 10c from line 9. This is your **adjusted gross income** ▶			11	9,000
12	**Standard deduction or itemized deductions** (from Schedule A)			12	1,100*
13	Qualified business income deduction. Attach Form 8995 or Form 8995-A			13	
14	Add lines 12 and 13			14	1,100
15	**Taxable income.** Subtract line 14 from line 11. If zero or less, enter -0-			15	7,900

Standard Deduction for—
- Single or Married filing separately, $12,400
- Married filing jointly or Qualifying widow(er), $24,800
- Head of household, $18,650
- If you checked any box under *Standard Deduction,* see instructions.

For Disclosure, Privacy Act, and Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11320B Form **1040** (2020)

*Standard deduction limited to greater of $350 ($0 earned income plus $350) or $1,100.

	16	**Tax** (see instructions). Check if any from Form(s): 1 ☐ 8814 2 ☐ 4972 3 ☐			16	1,607*
	17	Amount from Schedule 2, line 3			17	
	18	Add lines 16 and 17			18	1,607
	19	Child tax credit or credit for other dependents			19	
	20	Amount from Schedule 3, line 7			20	
	21	Add lines 19 and 20			21	
	22	Subtract line 21 from line 18. If zero or less, enter -0-			22	1,607
	23	Other taxes, including self-employment tax, from Schedule 2, line 10			23	
	24	Add lines 22 and 23. This is your **total tax** ▶			24	1,607
	25	Federal income tax withheld from:				
	a	Form(s) W-2	25a			
	b	Form(s) 1099	25b			
	c	Other forms (see instructions)	25c			
	d	Add lines 25a through 25c			25d	
• If you have a qualifying child, attach Sch. EIC. • If you have nontaxable combat pay, see instructions.	26	2020 estimated tax payments and amount applied from 2019 return			26	
	27	Earned income credit (EIC)	27			
	28	Additional child tax credit. Attach Schedule 8812	28			
	29	American opportunity credit from Form 8863, line 8	29			
	30	Recovery rebate credit. See instructions	30			
	31	Amount from Schedule 3, line 13	31			
	32	Add lines 27 through 31. These are your **total other payments and refundable credits** ▶			32	
	33	Add lines 25d, 26, and 32. These are your **total payments** ▶			33	-0-
Refund	34	If line 33 is more than line 24, subtract line 24 from line 33. This is the amount you **overpaid**			34	
	35a	Amount of line 34 you want **refunded to you.** If Form 8888 is attached, check here ▶ ☐			35a	
Direct deposit? See instructions.	▶ b	Routing number ▶ **c** Type: ☐ Checking ☐ Savings				
	▶ d	Account number				
	36	Amount of line 34 you want **applied to your 2021 estimated tax** ▶	36			
Amount You Owe	37	Subtract line 33 from line 24. This is the **amount you owe now** ▶			37	1,607
For details on how to pay, see instructions.		**Note:** Schedule H and Schedule SE filers, line 37 may not represent all of the taxes you owe for 2020. See Schedule 3, line 12e, and its instructions for details.				
	38	Estimated tax penalty (see instructions) ▶	38			

Third Party Designee

Do you want to allow another person to discuss this return with the IRS? See instructions ▶ ☐ **Yes.** Complete below. ☐ **No**

Designee's name ▶ Phone no. ▶ Personal identification number (PIN) ▶

Sign Here

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Joint return? See instructions. Keep a copy for your records.

Your signature	Date	Your occupation	If the IRS sent you an Identity Protection PIN, enter it here (see inst.) ▶
		Student	
Spouse's signature. If a joint return, **both** must sign.	Date	Spouse's occupation	If the IRS sent your spouse an Identity Protection PIN, enter it here (see inst.) ▶
Phone no.	Email address		

Paid Preparer Use Only

Preparer's name	Preparer's signature	Date	PTIN	Check if: ☐ Self-employed
Firm's name ▶			Phone no.	
Firm's address ▶			Firm's EIN ▶	

Go to *www.irs.gov/Form1040* for instructions and the latest information. Form **1040** (2020)

* From Line 18 of Form 8615.

Form **8615**

Department of the Treasury
Internal Revenue Service (99)

Tax for Certain Children Who Have Unearned Income

▶ Attach only to the child's Form 1040 or Form 1040-NR.
▶ Go to *www.irs.gov/Form8615* for instructions and the latest information.

OMB No. 1545-0074
2020
Attachment Sequence No. 33

Child's name shown on return	Child's social security number
Tracy M. Kidwell	433-33-3333

Before you begin: If the child, the parent, or any of the parent's other children for whom Form 8615 must be filed must use the Schedule D Tax Worksheet or has income from farming or fishing, see **Pub. 929,** Tax Rules for Children and Dependents. It explains how to figure the child's tax using the **Schedule D Tax Worksheet** or **Schedule J** (Form 1040).

A Parent's name (first, initial, and last). **Caution:** See instructions before completing.	B Parent's social security number
Kelly S. Kidwell	433-33-1111

C Parent's filing status (check one):
☐ Single ☑ Married filing jointly ☐ Married filing separately ☐ Head of household ☐ Qualifying widow(er)

Part I Child's Net Unearned Income

1	Enter the child's unearned income. See Instructions			1	9,000
2	If the child **did not** itemize deductions on **Schedule A** (Form 1040 or Form 1040-NR), enter $2,200. Otherwise, see instructions			2	2,200
3	Subtract line 2 from line 1. If zero or less, **stop;** do not complete the rest of this form but **do** attach it to the child's return			3	6,800
4	Enter the child's **taxable income** from Form 1040 or 1040-NR, line 15. If the child files Form 2555, see the instructions			4	7,900
5	Enter the **smaller** of line 3 or line 4. If zero, **stop;** do not complete the rest of this form but **do** attach it to the child's return			5	6,800

Part II Tentative Tax Based on the Tax Rate of the Parent

6	Enter the parent's **taxable income** from Form 1040 or 1040-NR, line 15. If zero or less, enter -0-. If the parent files Form 2555, see the instructions			6	132,000
7	Enter the total, if any, from Forms 8615, line 5, of **all other** children of the parent named above. **Do not** include the amount from line 5 above			7	
8	Add lines 5, 6, and 7. See instructions			8	138,800
9	Enter the tax on the amount on line 8 based on the **parent's** filing status above. See instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ▶ ☐			9	22,116[a]
10	Enter the parent's tax from Form 1040 or 1040-NR, line 16, minus any alternative minimum tax. **Do not** include any tax from **Form 4972, 8814,** or **8885** or any tax from recapture of an education credit. If the parent files Form 2555, see the instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) was used to figure the tax, check here ▶ ☐			10	20,620[b]
11	Subtract line 10 from line 9 and enter the result. If line 7 is blank, also enter this amount on line 13 and go to **Part III**			11	1,496
12a	Add lines 5 and 7	12a	6,800		
b	Divide line 5 by line 12a. Enter the result as a decimal (rounded to at least three places)			12b	x 1.000
13	Multiply line 11 by line 12b			13	1,496

Part III Child's Tax—If lines 4 and 5 above are the same, enter -0- on line 15 and go to line 16.

14	Subtract line 5 from line 4	14	1,100		
15	Enter the tax on the amount on line 14 based on the **child's** filing status. See instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ▶ ☐			15	111[c]
16	Add lines 13 and 15			16	1,607
17	Enter the tax on the amount on line 4 based on the **child's** filing status. See instructions. If the Qualified Dividends and Capital Gain Tax Worksheet, Schedule D Tax Worksheet, or Schedule J (Form 1040) is used to figure the tax, check here ▶ ☐			17	793[d]
18	Enter the **larger** of line 16 or line 17 here and on the **child's** Form 1040 or 1040-NR, line 16. If the child files Form 2555, see the instructions			18	1,607

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 64113U Form **8615** (2020)

[a] $9,235.00 + .22($138,800 - $80,250)
[b] $9,235.00 + .22($132,000 - $80,250)
[c] From 2020 Tax Table. The amount on Line 15 would be $110 ($1,100 × 0.10) if the tax rate schedule were used instead.
[d] From 2020 Tax Table. The amount on Line 17 would be $790 ($7,900 × 0.10) if the tax rate schedule were used instead.

Melodic Musical Sales, Inc.
XX-2022020 2020 Form 1120

Notes to Instructor:

Instructors may want to simplify the tax return project by giving students some or all of the following information rather than having them calculate the items:

Current year depreciation on property placed in service before 2020:

Building ($2,000,000 × 0.02564)	$ 51,280
Equipment 1 ($250,000 × 0.1249 × 0.5)	15,613
Equipment 2 ($500,000 × 0.1249)	62,450
Trucks ($100,000 × 0.192)	19,200
Total	$148,543

Current year depreciation on equipment placed in service in 2020:

Sec. 179 expensing	$600,000

Total current-year depreciation	$748,543

Capital gains and losses for 2020:

Short-term capital gain on sale of PDQ stock	$ 55,000
Long-term capital loss on sale of JSB stock	(10,000)

Sale of Equipment 1:

Selling price		$280,000
Cost	$250,000	
Minus: Accumulated depreciation	(156,288)	
Adjusted basis		(93,712)
Gain recognized		$186,288
Sec. 1245 recapture		$156,288
Sec. 1231 gain		$ 30,000

Underpayment penalty:

Omit Form 2220 and just insert $1,860 penalty on Form 1120, Page 1, Line 33.

Schedule M-3:

Omit this schedule.

Form **1120**
Department of the Treasury
Internal Revenue Service

U.S. Corporation Income Tax Return

For calendar year 2020 or tax year beginning ______, 2020, ending ______, 20 ___

▶ Go to *www.irs.gov/Form1120* for instructions and the latest information.

OMB No. 1545-0123

2020

A Check if: 1a Consolidated return (attach Form 851) ☐; b Life/nonlife consolidated return ☐; 2 Personal holding co. (attach Sch. PH) ☐; 3 Personal service corp. (see instructions) ☐; 4 Schedule M-3 attached ☑	TYPE OR PRINT — Name: Melodic Musical Sales, Inc.	**B** Employer identification number: XX-2022020
	Number, street, and room or suite no. If a P.O. box, see instructions: 5500 Fourth Avenue	**C** Date incorporated: 12/31/2016
	City or town, state or province, country, and ZIP or foreign postal code: City, ST 98765	**D** Total assets (see instructions): $ 7,955,494

E Check if: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change

Income	1a	Gross receipts or sales	1a	10,000,000		
	b	Returns and allowances	1b	250,000		
	c	Balance. Subtract line 1b from line 1a			1c	9,750,000
	2	Cost of goods sold (attach Form 1125-A)			2	4,500,000
	3	Gross profit. Subtract line 2 from line 1c			3	5,250,000
	4	Dividends and inclusions (Schedule C, line 23)			4	12,000
	5	Interest			5	
	6	Gross rents			6	
	7	Gross royalties			7	
	8	Capital gain net income (attach Schedule D (Form 1120))			8	60,000
	9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)			9	156,288
	10	Other income (see instructions—attach statement)			10	
	11	**Total income.** Add lines 3 through 10 ▶			11	5,478,288
Deductions (See instructions for limitations on deductions.)	12	Compensation of officers (see instructions—attach Form 1125-E) ▶			12	650,000
	13	Salaries and wages (less employment credits)			13	400,000
	14	Repairs and maintenance			14	20,500
	15	Bad debts			15	40,000
	16	Rents			16	
	17	Taxes and licenses			17	137,000
	18	Interest (see instructions)			18	210,000
	19	Charitable contributions			19	30,000
	20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)			20	748,543
	21	Depletion			21	
	22	Advertising			22	48,000
	23	Pension, profit-sharing, etc., plans			23	
	24	Employee benefit programs			24	
	25	Reserved for future use			25	
	26	Other deductions (attach statement)			26	177,000
	27	**Total deductions.** Add lines 12 through 26 ▶			27	2,461,043
	28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11.			28	3,017,245
	29a	Net operating loss deduction (see instructions)	29a			
	b	Special deductions (Schedule C, line 24)	29b	6,000		
	c	Add lines 29a and 29b			29c	6,000
Tax, Refundable Credits, and Payments	30	**Taxable income.** Subtract line 29c from line 28. See instructions			30	3,011,245
	31	Total tax (Schedule J, Part I, line 11)			31	632,361
	32	2020 net 965 tax liability paid (Schedule J, Part II, line 12)			32	
	33	Total payments, credits, and section 965 net tax liability (Schedule J, Part III, line 23)			33	555,000
	34	Estimated tax penalty. See instructions. Check if Form 2220 is attached ▶ ☑			34	1,860
	35	**Amount owed.** If line 33 is smaller than the total of lines 31, 32, and 34, enter amount owed			35	79,221
	36	**Overpayment.** If line 33 is larger than the total of lines 31, 32, and 34, enter amount overpaid			36	
	37	Enter amount from line 36 you want: **Credited to 2021 estimated tax** ▶		**Refunded** ▶	37	

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

Mary Travis — Signature of officer | 4/14/21 — Date | President — Title

May the IRS discuss this return with the preparer shown below? See instructions. ☐ Yes ☐ No

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN

Firm's name ▶ | Firm's EIN ▶
Firm's address ▶ | Phone no.

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11450Q Form **1120** (2020)

Schedule C	**Dividends, Inclusions, and Special Deductions** (see instructions)	**(a)** Dividends and inclusions	**(b)** %	**(c)** Special deductions **(a)** × **(b)**
1	Dividends from less-than-20%-owned domestic corporations (other than debt-financed stock)	12,000	50	6,000
2	Dividends from 20%-or-more-owned domestic corporations (other than debt-financed stock)		65	
3	Dividends on certain debt-financed stock of domestic and foreign corporations		see instructions	
4	Dividends on certain preferred stock of less-than-20%-owned public utilities		23.3	
5	Dividends on certain preferred stock of 20%-or-more-owned public utilities		26.7	
6	Dividends from less-than-20%-owned foreign corporations and certain FSCs		50	
7	Dividends from 20%-or-more-owned foreign corporations and certain FSCs		65	
8	Dividends from wholly owned foreign subsidiaries		100	
9	**Subtotal.** Add lines 1 through 8. See instructions for limitations	12,000	see instructions	6,000
10	Dividends from domestic corporations received by a small business investment company operating under the Small Business Investment Act of 1958		100	
11	Dividends from affiliated group members		100	
12	Dividends from certain FSCs		100	
13	Foreign-source portion of dividends received from a specified 10%-owned foreign corporation (excluding hybrid dividends) (see instructions)		100	
14	Dividends from foreign corporations not included on line 3, 6, 7, 8, 11, 12, or 13 (including any hybrid dividends)			
15	Section 965(a) inclusion		see instructions	
16a	Subpart F inclusions derived from the sale by a controlled foreign corporation (CFC) of the stock of a lower-tier foreign corporation treated as a dividend (attach Form(s) 5471) (see instructions)		100	
b	Subpart F inclusions derived from hybrid dividends of tiered corporations (attach Form(s) 5471) (see instructions)			
c	Other inclusions from CFCs under subpart F not included on line 15, 16a, 16b, or 17 (attach Form(s) 5471) (see instructions)			
17	Global Intangible Low-Taxed Income (GILTI) (attach Form(s) 5471 and Form 8992)			
18	Gross-up for foreign taxes deemed paid			
19	IC-DISC and former DISC dividends not included on line 1, 2, or 3			
20	Other dividends			
21	Deduction for dividends paid on certain preferred stock of public utilities			
22	Section 250 deduction (attach Form 8993)			
23	**Total dividends and inclusions.** Add column (a), lines 9 through 20. Enter here and on page 1, line 4 ▶	12,000		
24	**Total special deductions.** Add column (c), lines 9 through 22. Enter here and on page 1, line 29b ▶			6,000

Form **1120** (2020)

Schedule J **Tax Computation and Payment** (see instructions)

Part I—Tax Computation

1	Check if the corporation is a member of a controlled group (attach Schedule O (Form 1120)). See instructions ▶ ☐				
2	Income tax. See instructions ▶ ☐			2	632,361
3	Base erosion minimum tax amount (attach Form 8991)			3	
4	Add lines 2 and 3			4	632,361
5a	Foreign tax credit (attach Form 1118)	5a			
b	Credit from Form 8834 (see instructions)	5b			
c	General business credit (attach Form 3800)	5c			
d	Credit for prior year minimum tax (attach Form 8827)	5d			
e	Bond credits from Form 8912	5e			
6	**Total credits.** Add lines 5a through 5e			6	
7	Subtract line 6 from line 4			7	632,361
8	Personal holding company tax (attach Schedule PH (Form 1120))			8	
9a	Recapture of investment credit (attach Form 4255)	9a			
b	Recapture of low-income housing credit (attach Form 8611)	9b			
c	Interest due under the look-back method—completed long-term contracts (attach Form 8697)	9c			
d	Interest due under the look-back method—income forecast method (attach Form 8866)	9d			
e	Alternative tax on qualifying shipping activities (attach Form 8902)	9e			
f	Interest/tax due under Section 453A(c) and/or Section 453(l)	9f			
g	Other (see instructions—attach statement)	9g			
10	**Total.** Add lines 9a through 9g			10	
11	**Total tax.** Add lines 7, 8, and 10. Enter here and on page 1, line 31			11	632,361

Part II—Section 965 Payments (see instructions)

12	2020 net 965 tax liability paid from Form 965-B, Part II, column (k), line 4. Enter here and on page 1, line 32	12	

Part III—Payments, Refundable Credits, and Section 965 Net Tax Liability

13	2019 overpayment credited to 2020			13	
14	2020 estimated tax payments			14	555,000
15	2020 refund applied for on Form 4466			15	( )
16	Combine lines 13, 14, and 15			16	555,000
17	Tax deposited with Form 7004			17	
18	Withholding (see instructions)			18	
19	**Total payments.** Add lines 16, 17, and 18			19	555,000
20	Refundable credits from:				
a	Form 2439	20a			
b	Form 4136	20b			
c	Reserved for future use	20c			
d	Other (attach statement—see instructions)	20d			
21	**Total credits.** Add lines 20a through 20d			21	
22	2020 net 965 tax liability from Form 965-B, Part I, column (d), line 4. See instructions			22	
23	**Total payments, credits, and section 965 net tax liability.** Add lines 19, 21, and 22. Enter here and on page 1, line 33			23	555,000

Form **1120** (2020)

Schedule K Other Information (see instructions)

		Yes	No
1	Check accounting method: a ☐ Cash b ☑ Accrual c ☐ Other (specify) ▶		
2	See the instructions and enter the:		
a	Business activity code no. ▶ 451140		
b	Business activity ▶ Retail sales		
c	Product or service ▶ Musical instruments		
3	Is the corporation a subsidiary in an affiliated group or a parent-subsidiary controlled group? If "Yes," enter name and EIN of the parent corporation ▶		✓
4	At the end of the tax year:		
a	Did any foreign or domestic corporation, partnership (including any entity treated as a partnership), trust, or tax-exempt organization own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote? If "Yes," complete Part I of Schedule G (Form 1120) (attach Schedule G)		✓
b	Did any individual or estate own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of the corporation's stock entitled to vote? If "Yes," complete Part II of Schedule G (Form 1120) (attach Schedule G) *	✓	
5	At the end of the tax year, did the corporation:		
a	Own directly 20% or more, or own, directly or indirectly, 50% or more of the total voting power of all classes of stock entitled to vote of any foreign or domestic corporation not included on **Form 851,** Affiliations Schedule? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below.		✓

(i) Name of Corporation	**(ii)** Employer Identification Number (if any)	**(iii)** Country of Incorporation	**(iv)** Percentage Owned in Voting Stock

		Yes	No
b	Own directly an interest of 20% or more, or own, directly or indirectly, an interest of 50% or more in any foreign or domestic partnership (including an entity treated as a partnership) or in the beneficial interest of a trust? For rules of constructive ownership, see instructions. If "Yes," complete (i) through (iv) below.		✓

(i) Name of Entity	**(ii)** Employer Identification Number (if any)	**(iii)** Country of Organization	**(iv)** Maximum Percentage Owned in Profit, Loss, or Capital

		Yes	No
6	During this tax year, did the corporation pay dividends (other than stock dividends and distributions in exchange for stock) in excess of the corporation's current and accumulated earnings and profits? See sections 301 and 316. If "Yes," file **Form 5452,** Corporate Report of Nondividend Distributions. See the instructions for Form 5452. If this is a consolidated return, answer here for the parent corporation and on Form 851 for each subsidiary.		✓
7	At any time during the tax year, did one foreign person own, directly or indirectly, at least 25% of the total voting power of all classes of the corporation's stock entitled to vote or at least 25% of the total value of all classes of the corporation's stock? For rules of attribution, see section 318. If "Yes," enter: **(a)** Percentage owned ▶ and **(b)** Owner's country ▶ **(c)** The corporation may have to file **Form 5472,** Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business. Enter the number of Forms 5472 attached ▶		✓
8	Check this box if the corporation issued publicly offered debt instruments with original issue discount ▶ ☐ If checked, the corporation may have to file **Form 8281,** Information Return for Publicly Offered Original Issue Discount Instruments.		
9	Enter the amount of tax-exempt interest received or accrued during the tax year ▶ $ 5,000		
10	Enter the number of shareholders at the end of the tax year (if 100 or fewer) ▶ 3		
11	If the corporation has an NOL for the tax year and is electing to forego the carryback period, check here (see instructions) ▶ ☐ If the corporation is filing a consolidated return, the statement required by Regulations section 1.1502-21(b)(3) must be attached or the election will not be valid.		
12	Enter the available NOL carryover from prior tax years (do not reduce it by any deduction reported on page 1, line 29a.) ▶ $ N/A		

*Schedule G is not attached. If attached, with these facts, it would show the same information as shown on Form 1125-E.

Schedule K **Other Information** *(continued from page 4)*

		Yes	No
13	Are the corporation's total receipts (page 1, line 1a, plus lines 4 through 10) for the tax year **and** its total assets at the end of the tax year less than $250,000?		✓
	If "Yes," the corporation is not required to complete Schedules L, M-1, and M-2. Instead, enter the total amount of cash distributions and the book value of property distributions (other than cash) made during the tax year ▶ $		
14	Is the corporation required to file Schedule UTP (Form 1120), Uncertain Tax Position Statement? See instructions		✓
	If "Yes," complete and attach Schedule UTP.		
15a	Did the corporation make any payments in 2020 that would require it to file Form(s) 1099?		✓
b	If "Yes," did or will the corporation file required Form(s) 1099?		
16	During this tax year, did the corporation have an 80%-or-more change in ownership, including a change due to redemption of its own stock?		✓
17	During or subsequent to this tax year, but before the filing of this return, did the corporation dispose of more than 65% (by value) of its assets in a taxable, non-taxable, or tax deferred transaction?		✓
18	Did the corporation receive assets in a section 351 transfer in which any of the transferred assets had a fair market basis or fair market value of more than $1 million?		✓
19	During the corporation's tax year, did the corporation make any payments that would require it to file Forms 1042 and 1042-S under chapter 3 (sections 1441 through 1464) or chapter 4 (sections 1471 through 1474) of the Code?		✓
20	Is the corporation operating on a cooperative basis?		✓
21	During the tax year, did the corporation pay or accrue any interest or royalty for which the deduction is not allowed under section 267A? See instructions		✓
	If "Yes," enter the total amount of the disallowed deductions ▶ $		
22	Does the corporation have gross receipts of at least $500 million in any of the 3 preceding tax years? (See sections 59A(e)(2) and (3))		✓
	If "Yes," complete and attach Form 8991.		
23	Did the corporation have an election under section 163(j) for any real property trade or business or any farming business in effect during the tax year? See instructions		✓
24	Does the corporation satisfy one or more of the following? See instructions		✓
a	The corporation owns a pass-through entity with current, or prior year carryover, excess business interest expense.		
b	The corporation's aggregate average annual gross receipts (determined under section 448(c)) for the 3 tax years preceding the current tax year are more than $26 million and the corporation has business interest expense.		
c	The corporation is a tax shelter and the corporation has business interest expense.		
	If "Yes," complete and attach Form 8990.		
25	Is the corporation attaching Form 8996 to certify as a Qualified Opportunity Fund?		✓
	If "Yes," enter amount from Form 8996, line 15 ▶ $		
26	Since December 22, 2017, did a foreign corporation directly or indirectly acquire substantially all of the properties held directly or indirectly by the corporation, and was the ownership percentage (by vote or value) for purposes of section 7874 greater than 50% (for example, the shareholders held more than 50% of the stock of the foreign corporation)? If "Yes," list the ownership percentage by vote and by value. See instructions		✓
	Percentage: By Vote By Value		

Schedule L **Balance Sheets per Books**

Assets	Beginning of tax year (a)	(b)	End of tax year (c)	(d)
1 Cash		516,774		815,494
2a Trade notes and accounts receivable	400,000		500,000	
b Less allowance for bad debts	(20,000)	380,000	(25,000)	475,000
3 Inventories		2,500,000		3,500,000
4 U.S. government obligations				
5 Tax-exempt securities (see instructions)		30,000		30,000
6 Other current assets (attach statement)				
7 Loans to shareholders				
8 Mortgage and real estate loans				
9 Other investments (attach statement)		260,000		50,000
10a Buildings and other depreciable assets	2,850,000		3,200,000	
b Less accumulated depreciation	(317,500)	2,532,500	(395,000)	2,805,000
11a Depletable assets				
b Less accumulated depletion	( )		( )	
12 Land (net of any amortization)		200,000		200,000
13a Intangible assets (amortizable only)				
b Less accumulated amortization	( )		( )	
14 Other assets (attach statement)		60,000		80,000
15 Total assets		6,479,274		7,955,494
Liabilities and Shareholders' Equity				
16 Accounts payable		300,000		270,000
17 Mortgages, notes, bonds payable in less than 1 year		800,000		640,000
18 Other current liabilities (attach statement)		21,880		103,461
19 Loans from shareholders				
20 Mortgages, notes, bonds payable in 1 year or more		1,800,000		600,000
21 Other liabilities (attach statement)		57,394		167,593
22 Capital stock: a Preferred stock				
b Common stock	1,500,000	1,500,000	1,500,000	1,500,000
23 Additional paid-in capital				
24 Retained earnings—Appropriated (attach statement)				
25 Retained earnings—Unappropriated		2,000,000		4,674,440
26 Adjustments to shareholders' equity (attach statement)				
27 Less cost of treasury stock		( )		( )
28 Total liabilities and shareholders' equity		6,479,274		7,955,494

Schedule M-1 **Reconciliation of Income (Loss) per Books With Income per Return**

Note: The corporation may be required to file Schedule M-3. See instructions.

1 Net income (loss) per books	2,774,440	7 Income recorded on books this year not included on this return (itemize): Tax-exempt interest $ 5,000	5,000
2 Federal income tax per books	742,560		
3 Excess of capital losses over capital gains			
4 Income subject to tax not recorded on books this year (itemize): Gain on equip. (186,288 – 105,000)*	81,288	8 Deductions on this return not charged against book income this year (itemize): a Depreciation $ 596,043* b Charitable contributions $ Cap. loss C/O 15,000	611,043
5 Expenses recorded on books this year not deducted on this return (itemize): a Depreciation $ b Charitable contributions $ c Travel and entertainment $ See schedule	35,000	9 Add lines 7 and 8	616,043
6 Add lines 1 through 5	3,633,288	10 Income (page 1, line 28)—line 6 less line 9	3,017,245

Schedule M-2 **Analysis of Unappropriated Retained Earnings per Books (Schedule L, Line 25)**

1 Balance at beginning of year	2,000,000	5 Distributions: a Cash	100,000
2 Net income (loss) per books	2,774,440	b Stock	
3 Other increases (itemize):		c Property	
		6 Other decreases (itemize):	
		7 Add lines 5 and 6	100,000
4 Add lines 1, 2, and 3	4,774,440	8 Balance at end of year (line 4 less line 7)	4,674,440

Form **1120** (2020)

*See schedule on p. C:TRP-21 for additional information.

SCHEDULE D (Form 1120)
Department of the Treasury
Internal Revenue Service

Capital Gains and Losses

▶ Attach to Form 1120, 1120-C, 1120-F, 1120-FSC, 1120-H, 1120-IC-DISC, 1120-L, 1120-ND, 1120-PC, 1120-POL, 1120-REIT, 1120-RIC, 1120-SF, or certain Forms 990-T.
▶ Go to *www.irs.gov/Form1120* for instructions and the latest information.

OMB No. 1545-0123
2020

Name: Melodic Musical Sales, Inc.
Employer identification number: XX-2022020

Did the corporation dispose of any investment(s) in a qualified opportunity fund during the tax year? . . . . ▶ ☐ Yes ☐ No
If "Yes," attach Form 8949 and see its instructions for additional requirements for reporting your gain or loss.

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	**(d)** Proceeds (sales price)	**(e)** Cost (or other basis)	**(g)** Adjustments to gain or loss from Form(s) 8949, Part I, line 2, column (g)	**(h) Gain or (loss)** Subtract column (e) from column (d) and combine the result with column (g)
1a Totals for all short-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 1b				
1b Totals for all transactions reported on Form(s) 8949 with **Box A** checked				
2 Totals for all transactions reported on Form(s) 8949 with **Box B** checked				
3 Totals for all transactions reported on Form(s) 8949 with **Box C** checked	145,000	90,000		55,000

4 Short-term capital gain from installment sales from Form 6252, line 26 or 37	4	
5 Short-term capital gain or (loss) from like-kind exchanges from Form 8824	5	
6 Unused capital loss carryover (attach computation)	6	(15,000)
7 Net short-term capital gain or (loss). Combine lines 1a through 6 in column h	7	40,000

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

See instructions for how to figure the amounts to enter on the lines below. This form may be easier to complete if you round off cents to whole dollars.	**(d)** Proceeds (sales price)	**(e)** Cost (or other basis)	**(g)** Adjustments to gain or loss from Form(s) 8949, Part II, line 2, column (g)	**(h) Gain or (loss)** Subtract column (e) from column (d) and combine the result with column (g)
8a Totals for all long-term transactions reported on Form 1099-B for which basis was reported to the IRS and for which you have no adjustments (see instructions). However, if you choose to report all these transactions on Form 8949, leave this line blank and go to line 8b				
8b Totals for all transactions reported on Form(s) 8949 with **Box D** checked				
9 Totals for all transactions reported on Form(s) 8949 with **Box E** checked				
10 Totals for all transactions reported on Form(s) 8949 with **Box F** checked	110,000	120,000		(10,000)

11 Enter gain from Form 4797, line 7 or 9	11	30,000
12 Long-term capital gain from installment sales from Form 6252, line 26 or 37	12	
13 Long-term capital gain or (loss) from like-kind exchanges from Form 8824	13	
14 Capital gain distributions (see instructions)	14	
15 Net long-term capital gain or (loss). Combine lines 8a through 14 in column h	15	20,000

Part III Summary of Parts I and II

16 Enter excess of net short-term capital gain (line 7) over net long-term capital loss (line 15)	16	40,000
17 Net capital gain. Enter excess of net long-term capital gain (line 15) over net short-term capital loss (line 7)	17	20,000
18 Add lines 16 and 17. Enter here and on Form 1120, page 1, line 8, or the applicable line on other returns	18	60,000

Note: If losses exceed gains, see *Capital Losses* in the instructions.

For Paperwork Reduction Act Notice, see the Instructions for Form 1120. Cat. No. 11460M **Schedule D (Form 1120) 2020**

Form **8949**

Department of the Treasury
Internal Revenue Service

Sales and Other Dispositions of Capital Assets

▶ Go to *www.irs.gov/Form8949* for instructions and the latest information.
▶ File with your Schedule D to list your transactions for lines 1b, 2, 3, 8b, 9, and 10 of Schedule D.

OMB No. 1545-0074
2020
Attachment Sequence No. **12A**

Name(s) shown on return: Melodic Musical Sales, Inc.

Social security number or taxpayer identification number: XX-2022020

Before you check Box A, B, or C below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part I **Short-Term.** Transactions involving capital assets you held 1 year or less are generally short-term (see instructions). For long-term transactions, see page 2.

Note: You may aggregate all short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 1a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box A, B, *or* C below. Check only one box. If more than one box applies for your short-term transactions, complete a separate Form 8949, page 1, for each applicable box. If you have more short-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

☐ **(A)** Short-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
☐ **(B)** Short-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
☑ **(C)** Short-term transactions not reported to you on Form 1099-B

1 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the **Note** below and see *Column (e)* in the separate instructions	**Adjustment, if any, to gain or loss.** If you enter an amount in column (g), enter a code in column (f). **See the separate instructions.** (f) Code(s) from instructions	(g) Amount of adjustment	(h) **Gain or (loss).** Subtract column (e) from column (d) and combine the result with column (g)
100 shares PDQ Corp.	12/12/19	10/8/20	145,000	90,000			55,000
2 Totals. Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, **line 1b** (if **Box A** above is checked), **line 2** (if **Box B** above is checked), or **line 3** (if **Box C** above is checked) ▶			145,000	90,000			55,000

Note: If you checked Box A above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See *Column (g)* in the separate instructions for how to figure the amount of the adjustment.

For Paperwork Reduction Act Notice, see your tax return instructions. Cat. No. 37768Z Form **8949** (2020)

Form 8949 (2020) Attachment Sequence No. **12A** Page **2**

Name(s) shown on return. Name and SSN or taxpayer identification no. not required if shown on other side: Melodic Musical Sales, Inc.

Social security number or taxpayer identification number: XX-2022020

Before you check Box D, E, or F below, see whether you received any Form(s) 1099-B or substitute statement(s) from your broker. A substitute statement will have the same information as Form 1099-B. Either will show whether your basis (usually your cost) was reported to the IRS by your broker and may even tell you which box to check.

Part II **Long-Term.** Transactions involving capital assets you held more than 1 year are generally long-term (see instructions). For short-term transactions, see page 1.

Note: You may aggregate all long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS and for which no adjustments or codes are required. Enter the totals directly on Schedule D, line 8a; you aren't required to report these transactions on Form 8949 (see instructions).

You *must* check Box D, E, *or* F below. Check only one box. If more than one box applies for your long-term transactions, complete a separate Form 8949, page 2, for each applicable box. If you have more long-term transactions than will fit on this page for one or more of the boxes, complete as many forms with the same box checked as you need.

- ☐ **(D)** Long-term transactions reported on Form(s) 1099-B showing basis was reported to the IRS (see **Note** above)
- ☐ **(E)** Long-term transactions reported on Form(s) 1099-B showing basis **wasn't** reported to the IRS
- ☑ **(F)** Long-term transactions not reported to you on Form 1099-B

1 (a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold or disposed of (Mo., day, yr.)	(d) Proceeds (sales price) (see instructions)	(e) Cost or other basis. See the **Note** below and see *Column (e)* in the separate instructions	Adjustment, if any, to gain or loss. If you enter an amount in column (g), enter a code in column (f). **See the separate instructions.** (f) Code(s) from instructions	(g) Amount of adjustment	(h) **Gain or (loss).** Subtract column (e) from column (d) and combine the result with column (g)
75 shares JSB Corp.	9/18/18	6/18/20	110,000	120,000			(10,000)
2 Totals. Add the amounts in columns (d), (e), (g), and (h) (subtract negative amounts). Enter each total here and include on your Schedule D, **line 8b** (if **Box D** above is checked), **line 9** (if **Box E** above is checked), or **line 10** (if **Box F** above is checked) ▶			110,000	120,000			(10,000)

Note: If you checked Box D above but the basis reported to the IRS was incorrect, enter in column (e) the basis as reported to the IRS, and enter an adjustment in column (g) to correct the basis. See *Column (g)* in the separate instructions for how to figure the amount of the adjustment.

Form **8949** (2020)

SCHEDULE M-3 (Form 1120)
(Rev. December 2019)
Department of the Treasury
Internal Revenue Service

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

▶ Attach to Form 1120 or 1120-C.
▶ Go to *www.irs.gov/Form1120* for instructions and the latest information.

OMB No. 1545-0123

Name of corporation (common parent, if consolidated return): Melodic Musical Sales, Inc.
Employer identification number: XX-2022020

Check applicable box(es): (1) ☑ Non-consolidated return (2) ☐ Consolidated return (Form 1120 only)
(3) ☐ Mixed 1120/L/PC group (4) ☐ Dormant subsidiaries schedule attached

Part I Financial Information and Net Income (Loss) Reconciliation (see instructions)

1a Did the corporation file SEC Form 10-K for its income statement period ending with or within this tax year?
☐ **Yes.** Skip lines 1b and 1c and complete lines 2a through 11 with respect to that SEC Form 10-K.
☑ **No.** Go to line 1b. See instructions if multiple non-tax-basis income statements are prepared.

b Did the corporation prepare a certified audited non-tax-basis income statement for that period?
☐ **Yes.** Skip line 1c and complete lines 2a through 11 with respect to that income statement.
☑ **No.** Go to line 1c.

c Did the corporation prepare a non-tax-basis income statement for that period?
☑ **Yes.** Complete lines 2a through 11 with respect to that income statement.
☐ **No.** Skip lines 2a through 3c and enter the corporation's net income (loss) per its books and records on line 4a.

2a Enter the income statement period: Beginning 01/01/2020 Ending 12/31/2020

b Has the corporation's income statement been restated for the income statement period on line 2a?
☐ **Yes.** (If "Yes," attach an explanation and the amount of each item restated.)
☑ **No.**

c Has the corporation's income statement been restated for any of the five income statement periods immediately preceding the period on line 2a?
☐ **Yes.** (If "Yes," attach an explanation and the amount of each item restated.)
☑ **No.**

3a Is any of the corporation's voting common stock publicly traded?
☐ **Yes.**
☑ **No.** If "No," go to line 4a.

b Enter the symbol of the corporation's primary U.S. publicly traded voting common stock . . . .

c Enter the nine-digit CUSIP number of the corporation's primary publicly traded voting common stock . . . .

4a	Worldwide consolidated net income (loss) from income statement source identified in Part I, line 1 .	4a	2,774,440
b	Indicate accounting standard used for line 4a (see instructions): (1) ☑ GAAP (2) ☐ IFRS (3) ☐ Statutory (4) ☐ Tax-basis (5) ☐ Other (specify)		
5a	Net income from nonincludible foreign entities (attach statement)	5a	( )
b	Net loss from nonincludible foreign entities (attach statement and enter as a positive amount)	5b	
6a	Net income from nonincludible U.S. entities (attach statement)	6a	( )
b	Net loss from nonincludible U.S. entities (attach statement and enter as a positive amount)	6b	
7a	Net income (loss) of other includible foreign disregarded entities (attach statement)	7a	
b	Net income (loss) of other includible U.S. disregarded entities (attach statement)	7b	
c	Net income (loss) of other includible entities (attach statement)	7c	
8	Adjustment to eliminations of transactions between includible entities and nonincludible entities (attach statement)	8	
9	Adjustment to reconcile income statement period to tax year (attach statement)	9	
10a	Intercompany dividend adjustments to reconcile to line 11 (attach statement)	10a	
b	Other statutory accounting adjustments to reconcile to line 11 (attach statement)	10b	
c	Other adjustments to reconcile to amount on line 11 (attach statement)	10c	
11	**Net income (loss) per income statement of includible corporations.** Combine lines 4 through 10 .	11	2,774,440

Note: Part I, line 11, must equal Part II, line 30, column (a) or Schedule M-1, line 1 (see instructions).

12 Enter the total amount (not just the corporation's share) of the assets and liabilities of all entities included or removed on the following lines.

	Total Assets	Total Liabilities
a Included on Part I, line 4 . . . . ▶	7,995,494	1,781,054
b Removed on Part I, line 5 . . . . ▶		
c Removed on Part I, line 6 . . . . ▶		
d Included on Part I, line 7 . . . . ▶		

Schedule M-3 (Form 1120) (Rev. 12-2019) Page 2

Name of corporation (common parent, if consolidated return): Melodic Musical Sales, Inc.

Employer identification number: XX-2022020

Check applicable box(es): (1) ☐ Consolidated group (2) ☐ Parent corp (3) ☐ Consolidated eliminations (4) ☐ Subsidiary corp (5) ☐ Mixed 1120/L/PC group

Check if a sub-consolidated: (6) ☐ 1120 group (7) ☐ 1120 eliminations

Name of subsidiary (if consolidated return) | Employer identification number

Part II Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return (see instructions)

Income (Loss) Items (Attach statements for lines 1 through 12)	(a) Income (Loss) per Income Statement	(b) Temporary Difference	(c) Permanent Difference	(d) Income (Loss) per Tax Return
1 Income (loss) from equity method foreign corporations				
2 Gross foreign dividends not previously taxed				
3 Subpart F, QEF, and similar income inclusions				
4 Gross-up for foreign taxes deemed paid				
5 Gross foreign distributions previously taxed				
6 Income (loss) from equity method U.S. corporations				
7 U.S. dividends not eliminated in tax consolidation	12,000			12,000
8 Minority interest for includible corporations				
9 Income (loss) from U.S. partnerships				
10 Income (loss) from foreign partnerships				
11 Income (loss) from other pass-through entities				
12 Items relating to reportable transactions				
13 Interest income (see instructions)	5,000[a]		(5,000)	-0-
14 Total accrual to cash adjustment				
15 Hedging transactions				
16 Mark-to-market income (loss)				
17 Cost of goods sold (see instructions)	(4,500,000)			(4,500,000)
18 Sale versus lease (for sellers and/or lessors)				
19 Section 481(a) adjustments				
20 Unearned/deferred revenue				
21 Income recognition from long-term contracts				
22 Original issue discount and other imputed interest				
23a Income statement gain/loss on sale, exchange, abandonment, worthlessness, or other disposition of assets other than inventory and pass-through entities	150,000[b]	(150,000)		
b Gross capital gains from Schedule D, excluding amounts from pass-through entities		85,000		85,000
c Gross capital losses from Schedule D, excluding amounts from pass-through entities, abandonment losses, and worthless stock losses		(10,000)		(10,000)
d Net gain/loss reported on Form 4797, line 17, excluding amounts from pass-through entities, abandonment losses, and worthless stock losses		156,288		156,288
e Abandonment losses				
f Worthless stock losses (attach statement)				
g Other gain/loss on disposition of assets other than inventory				
24 Capital loss limitation and carryforward used		(15,000)		(15,000)
25 Other income (loss) items with differences (attach statement)				
26 **Total income (loss) items.** Combine lines 1 through 25	(4,333,000)	66,288	(5,000)	(4,271,712)
27 **Total expense/deduction items** (from Part III, line 39)	(1,285,060)	(591,043)	772,560	(1,103,543)
28 Other items with no differences **	8,392,500			8,392,500
29a Mixed groups, see instructions. All others, combine lines 26 through 28	2,774,440	(524,755)	767,560	3,017,245
b PC insurance subgroup reconciliation totals				
c Life insurance subgroup reconciliation totals				
30 **Reconciliation totals.** Combine lines 29a through 29c	2,774,440	(524,755)	767,560	3,017,245

Note: Line 30, column (a), must equal Part I, line 11, and column (d) must equal Form 1120, page 1, line 28.

Schedule M-3 (Form 1120) (Rev. 12-2019)

[a] Tax-exempt interest.

[b] $105,000 equipment gain + $45,000 net stock gain.

Name of corporation (common parent, if consolidated return): Melodic Musical Sales, Inc.

Employer identification number: XX-2022020

Check applicable box(es): (1) ☐ Consolidated group (2) ☐ Parent corp (3) ☐ Consolidated eliminations (4) ☐ Subsidiary corp (5) ☐ Mixed 1120/L/PC group

Check if a sub-consolidated: (6) ☐ 1120 group (7) ☐ 1120 eliminations

Name of subsidiary (if consolidated return)

Employer identification number

Part III **Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return—Expense/Deduction Items** (see instructions)

Expense/Deduction Items	(a) Expense per Income Statement	(b) Temporary Difference	(c) Permanent Difference	(d) Deduction per Tax Return
1 U.S. current income tax expense	632,361		(632,361)	
2 U.S. deferred income tax expense *	110,199		(110,199)	
3 State and local current income tax expense	75,000			75,000
4 State and local deferred income tax expense				
5 Foreign current income tax expense (other than foreign withholding taxes)				
6 Foreign deferred income tax expense				
7 Foreign withholding taxes				
8 Interest expense (see instructions)	210,000			210,000
9 Stock option expense				
10 Other equity-based compensation				
11 Meals and entertainment				
12 Fines and penalties				
13 Judgments, damages, awards, and similar costs				
14 Parachute payments				
15 Compensation with section 162(m) limitation				
16 Pension and profit-sharing				
17 Other post-retirement benefits				
18 Deferred compensation				
19 Charitable contribution of cash and tangible property	30,000			30,000
20 Charitable contribution of intangible property				
21 Charitable contribution limitation/carryforward				
22 Domestic production activities deduction (see instructions)				
23 Current year acquisition or reorganization investment banking fees				
24 Current year acquisition or reorganization legal and accounting fees				
25 Current year acquisition/reorganization other costs				
26 Amortization/impairment of goodwill				
27 Amortization of acquisition, reorganization, and start-up costs				
28 Other amortization or impairment write-offs				
29 Reserved				
30 Depletion				
31 Depreciation	152,500	596,043		748,543
32 Bad debt expense	45,000	(5,000)		40,000
33 Corporate owned life insurance premiums	30,000		(30,000)	-0-
34 Purchase versus lease (for purchasers and/or lessees)				
35 Research and development costs				
36 Section 118 exclusion (attach statement)				
37 Section 162(r)—FDIC premiums paid by certain large financial institutions (see instructions)				
38 Other expense/deduction items with differences (attach statement)				
39 **Total expense/deduction items.** Combine lines 1 through 38. Enter here and on Part II, line 27, reporting positive amounts as negative and negative amounts as positive	1,285,060	591,043	(772,560)	1,103,543

*$742,560 FIT expense per books - $632,361 federal tax liability (ignoring penalty)

Form **1125-A** (Rev. November 2018) Department of the Treasury Internal Revenue Service

Cost of Goods Sold

▶ Attach to Form 1120, 1120-C, 1120-F, 1120S, or 1065.
▶ Go to *www.irs.gov/Form1125A* for the latest information.

OMB No. 1545-0123

Name: Melodic Musical Sales, Inc.

Employer identification number: XX-2022020

1	Inventory at beginning of year	1	2,500,000
2	Purchases	2	5,500,000
3	Cost of labor	3	
4	Additional section 263A costs (attach schedule)	4	
5	Other costs (attach schedule)	5	
6	**Total.** Add lines 1 through 5	6	8,000,000
7	Inventory at end of year	7	3,500,000
8	**Cost of goods sold.** Subtract line 7 from line 6. Enter here and on Form 1120, page 1, line 2 or the appropriate line of your tax return. See instructions	8	4,500,000

9a Check all methods used for valuing closing inventory:
- *(i)* ☐ Cost
- *(ii)* ☑ Lower of cost or market
- *(iii)* ☐ Other (Specify method used and attach explanation.) ▶

b Check if there was a writedown of subnormal goods ▶ ☐

c Check if the LIFO inventory method was adopted this tax year for any goods (if checked, attach Form 970) ▶ ☐

d If the LIFO inventory method was used for this tax year, enter amount of closing inventory computed under LIFO — 9d

e If property is produced or acquired for resale, do the rules of section 263A apply to the entity? See instructions ☐ Yes ☑ No

f Was there any change in determining quantities, cost, or valuations between opening and closing inventory? If "Yes," attach explanation ☐ Yes ☑ No

Section references are to the Internal Revenue Code unless otherwise noted.

What's New

Small business taxpayers. For tax years beginning after December 31, 2017, the following apply.

- A small business taxpayer (defined below), may use a method of accounting for inventories that either: (1) treats inventories as nonincidental materials and supplies, or (2) conforms to the taxpayer's financial accounting treatment of inventories.
- A small business taxpayer is not required to capitalize costs under section 263A.

General Instructions

Purpose of Form

Use Form 1125-A to calculate and deduct cost of goods sold for certain entities.

Who Must File

Filers of Form 1120, 1120-C, 1120-F, 1120S, or 1065, must complete and attach Form 1125-A if the applicable entity reports a deduction for cost of goods sold.

Inventories

Generally, inventories are required at the beginning and end of each tax year if the production, purchase, or sale of merchandise is an income-producing factor. See Regulations section 1.471-1. If inventories are required, you generally must use an accrual method of accounting for sales and purchases of inventory items.

Exception for certain taxpayers. A small business taxpayer (defined below) can adopt or change its accounting method to account for inventories in the same manner as material and supplies that are non-incidental, or conform to its treatment of inventories in an applicable financial statement (as defined in section 451(b)(3)), or if it does not have an applicable financial statement, the method of accounting used in its books and records prepared in accordance with its accounting procedures. See section 471(c)(3).

A small business taxpayer claiming exemption from the requirement to keep inventories is changing its method of accounting for purposes of section 481. For additional guidance on this method of accounting, see Pub. 538, Accounting Periods and Methods. For guidance on changing to this method of accounting, see Form 3115 and the Instructions for Form 3115.

Small business taxpayer. A small business taxpayer is a taxpayer that (a) has average annual gross receipts of $25 million or less (indexed for inflation) for the 3 prior tax years, and (b) is not a tax shelter (as defined in section 448(d)(3)). See Pub. 538.

Uniform capitalization rules. The uniform capitalization rules of section 263A generally require you to capitalize, or include in inventory, certain costs incurred in connection with the following.

- The production of real property and tangible personal property held in inventory or held for sale in the ordinary course of business.
- Real property or personal property (tangible and intangible) acquired for resale.
- The production of real property and tangible personal property for use in its trade or business or in an activity engaged in for profit.

A small business taxpayer (defined above) is not required to capitalize costs under section 263A. See section 263A(i).

See the discussion on section 263A uniform capitalization rules in the instructions for your tax return before completing Form 1125-A. Also see Regulations sections 1.263A-1 through 1.263A-3. See Regulations section 1.263A-4 for rules for property produced in a farming business.

Form **1125-E** (Rev. October 2016) Department of the Treasury Internal Revenue Service

Compensation of Officers

▶ Attach to Form 1120, 1120-C, 1120-F, 1120-REIT, 1120-RIC, or 1120S.
▶ Information about Form 1125-E and its separate instructions is at *www.irs.gov/form1125e*.

OMB No. 1545-0123

Name: Melodic Musical Sales, Inc.

Employer identification number: XX-2022020

Note: Complete Form 1125-E only if total receipts are $500,000 or more. See instructions for definition of total receipts.

	(a) Name of officer	(b) Social security number (see instructions)	(c) Percent of time devoted to business	Percent of stock owned (d) Common	Percent of stock owned (e) Preferred	(f) Amount of compensation
1	Mary Travis	XXX-XX-XXXX	100 %	50 %	%	290,000
	John Willis	XXX-XX-XXXX	100 %	25 %	%	180,000
	Chris Parker	XXX-XX-XXXX	100 %	25 %	%	180,000
			%	%	%	
			%	%	%	
			%	%	%	
			%	%	%	
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			%	%	%	
			%	%	%	
			%	%	%	

2	Total compensation of officers	2	650,000
3	Compensation of officers claimed on Form 1125-A or elsewhere on return	3	
4	Subtract line 3 from line 2. Enter the result here and on Form 1120, page 1, line 12 or the appropriate line of your tax return	4	650,000

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 55989C Form **1125-E** (Rev. 10-2016)

Form **2220**

Department of the Treasury
Internal Revenue Service

Underpayment of Estimated Tax by Corporations

▶ Attach to the corporation's tax return.
▶ Go to *www.irs.gov/Form2220* for instructions and the latest information.

OMB No. 1545-0123

2020

Name: Melodic Musical Sales, Inc.

Employer identification number: XX-2022020

Note: Generally, the corporation is not required to file Form 2220 (see Part II below for exceptions) because the IRS will figure any penalty owed and bill the corporation. However, the corporation may still use Form 2220 to figure the penalty. If so, enter the amount from page 2, line 38, on the estimated tax penalty line of the corporation's income tax return, but **do not** attach Form 2220.

Part I Required Annual Payment

1	Total tax (see instructions)			1	632,361
2a	Personal holding company tax (Schedule PH (Form 1120), line 26) included on line 1	2a			
b	Look-back interest included on line 1 under section 460(b)(2) for completed long-term contracts or section 167(g) for depreciation under the income forecast method	2b			
c	Credit for federal tax paid on fuels (see instructions)	2c			
d	**Total.** Add lines 2a through 2c			2d	
3	Subtract line 2d from line 1. If the result is less than $500, **do not** complete or file this form. The corporation does not owe the penalty			3	632,361
4	Enter the tax shown on the corporation's 2019 income tax return. See instructions. **Caution:** If the tax is zero or the tax year was for less than 12 months, skip this line and enter the amount from line 3 on line 5			4	252,000
5	**Required annual payment.** Enter the **smaller** of line 3 or line 4. If the corporation is required to skip line 4, enter the amount from line 3			5	252,000

Part II Reasons for Filing—Check the boxes below that apply. If any boxes are checked, the corporation must file Form 2220 even if it does not owe a penalty. See instructions.

6 ☐ The corporation is using the adjusted seasonal installment method.
7 ☐ The corporation is using the annualized income installment method.
8 ☑ The corporation is a "large corporation" figuring its first required installment based on the prior year's tax.

Part III Figuring the Underpayment

			(a)	(b)	(c)	(d)
9	**Installment due dates.** Enter in columns (a) through (d) the 15th day of the 4th (***Form 990-PF filers:*** Use 5th month), 6th, 9th, and 12th months of the corporation's tax year. **Filers with installments due on or after April 1, 2020, and before July 15, 2020, see instructions** *	9	7/15/20	7/15/20	9/15/20	12/15/20
10	**Required installments.** If the box on line 6 and/or line 7 above is checked, enter the amounts from Schedule A, line 38. If the box on line 8 (but not 6 or 7) is checked, see instructions for the amounts to enter. If none of these boxes are checked, enter 25% (0.25) of line 5 above in each column	10	63,000	253,181	158,090	158,090
11	Estimated tax paid or credited for each period. For column (a) only, enter the amount from line 11 on line 15. See instructions	11	-0-	225,000	165,000	165,000
	Complete lines 12 through 18 of one column before going to the next column.					
12	Enter amount, if any, from line 18 of the preceding column	12				
13	Add lines 11 and 12	13		225,000	165,000	165,000
14	Add amounts on lines 16 and 17 of the preceding column	14		63,000	91,181	84,271
15	Subtract line 14 from line 13. If zero or less, enter -0-	15	-0-	162,000	73,819	80,729
16	If the amount on line 15 is zero, subtract line 13 from line 14. Otherwise, enter -0-	16		-0-	-0-	
17	**Underpayment.** If line 15 is less than or equal to line 10, subtract line 15 from line 10. Then go to line 12 of the next column. Otherwise, go to line 18	17	63,000	91,181	84,271	77,361
18	**Overpayment.** If line 10 is less than line 15, subtract line 10 from line 15. Then go to line 12 of the next column	18				

Go to Part IV on page 2 to figure the penalty. Do not go to Part IV if there are no entries on line 17—no penalty is owed.

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11746L Form **2220** (2020)

*Even though some of the dates on this form fall on a weekend, the form nevertheless uses the fifteenth based on the following language in the instructions to Form 2220. If an installment is due on a Saturday, Sunday, or legal holiday, payments made on the next day that is not a Saturday, Sunday, or legal holiday are considered made on the due date to the extent the payment is applied against that required installment. Note: Columns (a) and (b) are dated 7/15/20 instead of 4/15/20 and 6/15/20 because the IRS extended the time of payment for these two installments under COVID relief provisions.

Part IV Figuring the Penalty

			(a)	(b)	(c)	(d)
19	Enter the date of payment or the 15th day of the 4th month after the close of the tax year, whichever is earlier. ***(C corporations with tax years ending June 30 and S corporations:*** Use 3rd month instead of 4th month. ***Form 990-PF and Form 990-T filers:*** Use 5th month instead of 4th month.) See instructions	19	7/15/20	9/15/20	12/15/20	4/15/21
20	Number of days from due date of installment on line 9 to the date shown on line 19	20	-0-	62	91	121
21	Number of days on line 20 after 4/15/2020 and before 7/1/2020	21	-0-	-0-		
22	Underpayment on line 17 × (Number of days on line 21 / 366) × 5% (0.05)	22	$ -0-	$ -0-	$	$
23	Number of days on line 20 after 6/30/2020 and before 10/1/2020	23		62	15	
24	Underpayment on line 17 × (Number of days on line 23 / 366) × 3% (0.03)	24	$	$ 463	$ 104	$
25	Number of days on line 20 after 9/30/2020 and before 1/1/2021	25			76	16
26	Underpayment on line 17 × (Number of days on line 25 / 366) × 3% (0.03)	26	$	$	$ 525	$ 101
27	Number of days on line 20 after 12/31/2020 and before 4/1/2021	27				90
28	Underpayment on line 17 × (Number of days on line 27 / 365) × 3% (0.03)	28	$	$	$	$ 572
29	Number of days on line 20 after 3/31/2021 and before 7/1/2021	29				15
30	Underpayment on line 17 × (Number of days on line 29 / 365) × *%	30	$	$	$	$ 95
31	Number of days on line 20 after 6/30/2021 and before 10/1/2021	31				
32	Underpayment on line 17 × (Number of days on line 31 / 365) × *%	32	$	$	$	$
33	Number of days on line 20 after 9/30/2021 and before 1/1/2022	33				
34	Underpayment on line 17 × (Number of days on line 33 / 365) × *%	34	$	$	$	$
35	Number of days on line 20 after 12/31/2021 and before 3/16/2022	35				
36	Underpayment on line 17 × (Number of days on line 35 / 365) × *%	36	$	$	$	$
37	Add lines 22, 24, 26, 28, 30, 32, 34, and 36	37	$ -0-	$ 463	$ 629	$ 768
38	**Penalty.** Add columns (a) through (d) of line 37. Enter the total here and on Form 1120, line 34; or the comparable line for other income tax returns	38				$ 1,860

*Use the penalty interest rate for each calendar quarter, which the IRS will determine during the first month in the preceding quarter. These rates are published quarterly in an IRS News Release and in a revenue ruling in the Internal Revenue Bulletin. To obtain this information on the Internet, access the IRS website at ***www.irs.gov***. You can also call 1-800-829-4933 to get interest rate information.

*Assumes rate on Line 30 remains at 3%.

Form **4562**

Department of the Treasury
Internal Revenue Service (99)

Depreciation and Amortization
(Including Information on Listed Property)
▶ Attach to your tax return.
▶ Go to *www.irs.gov/Form4562* for instructions and the latest information.

OMB No. 1545-0172
2020
Attachment Sequence No. 179

Name(s) shown on return	Business or activity to which this form relates	Identifying number
Melodic Musical Sales, Inc.	Retail Sales	XX-2022020

Part I **Election To Expense Certain Property Under Section 179**
Note: If you have any listed property, complete Part V before you complete Part I.

1	Maximum amount (see instructions)	1	600,000*
2	Total cost of section 179 property placed in service (see instructions)	2	600,000
3	Threshold cost of section 179 property before reduction in limitation (see instructions)	3	2,590,000
4	Reduction in limitation. Subtract line 3 from line 2. If zero or less, enter -0-	4	-0-
5	Dollar limitation for tax year. Subtract line 4 from line 1. If zero or less, enter -0-. If married filing separately, see instructions	5	600,000

6 (a) Description of property	(b) Cost (business use only)	(c) Elected cost
Equipment	600,000	600,000
7 Listed property. Enter the amount from line 29	7	

8	Total elected cost of section 179 property. Add amounts in column (c), lines 6 and 7	8	600,000
9	Tentative deduction. Enter the **smaller** of line 5 or line 8	9	600,000
10	Carryover of disallowed deduction from line 13 of your 2019 Form 4562	10	
11	Business income limitation. Enter the smaller of business income (not less than zero) or line 5. See instructions	11	600,000
12	Section 179 expense deduction. Add lines 9 and 10, but don't enter more than line 11	12	600,000
13	Carryover of disallowed deduction to 2021. Add lines 9 and 10, less line 12 ▶ 13		

Note: Don't use Part II or Part III below for listed property. Instead, use Part V.

Part II **Special Depreciation Allowance and Other Depreciation (Don't** include listed property. See instructions.**)**

14	Special depreciation allowance for qualified property (other than listed property) placed in service during the tax year. See instructions	14	
15	Property subject to section 168(f)(1) election	15	
16	Other depreciation (including ACRS)	16	

Part III **MACRS Depreciation (Don't** include listed property. See instructions.**)**

Section A

17	MACRS deductions for assets placed in service in tax years beginning before 2020	17	148,543
18	If you are electing to group any assets placed in service during the tax year into one or more general asset accounts, check here ▶ ☐		

Section B—Assets Placed in Service During 2020 Tax Year Using the General Depreciation System

(a) Classification of property	(b) Month and year placed in service	(c) Basis for depreciation (business/investment use only—see instructions)	(d) Recovery period	(e) Convention	(f) Method	(g) Depreciation deduction
19a 3-year property						
b 5-year property						
c 7-year property						
d 10-year property						
e 15-year property						
f 20-year property						
g 25-year property			25 yrs.		S/L	
h Residential rental			27.5 yrs.	MM	S/L	
property			27.5 yrs.	MM	S/L	
i Nonresidential real			39 yrs.	MM	S/L	
property				MM	S/L	

Section C—Assets Placed in Service During 2020 Tax Year Using the Alternative Depreciation System

(a) Classification of property	(b)	(c)	(d)	(e)	(f)	(g)
20a Class life					S/L	
b 12-year			12 yrs.		S/L	
c 30-year			30 yrs.	MM	S/L	
d 40-year			40 yrs.	MM	S/L	

Part IV **Summary** (See instructions.)

21	Listed property. Enter amount from line 28	21	
22	**Total.** Add amounts from line 12, lines 14 through 17, lines 19 and 20 in column (g), and line 21. Enter here and on the appropriate lines of your return. Partnerships and S corporations—see instructions	22	748,543
23	For assets shown above and placed in service during the current year, enter the portion of the basis attributable to section 263A costs 23		

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 12906N Form **4562** (2020)

*Per the worksheet in the instructions for Form 4562, Line 1 should be the lesser of the maximum Sec. 179 deduction ($1,040,000 in 2020) or the total cost of Sec. 179 property.

Form **4797**

Department of the Treasury
Internal Revenue Service

Sales of Business Property

(Also Involuntary Conversions and Recapture Amounts Under Sections 179 and 280F(b)(2))

▶ Attach to your tax return.
▶ Go to *www.irs.gov/Form4797* for instructions and the latest information.

OMB No. 1545-0184
2020
Attachment Sequence No. 27

Name(s) shown on return	Identifying number
Melodic Musical Sales, Inc.	XX-2022020

1	Enter the gross proceeds from sales or exchanges reported to you for 2020 on Form(s) 1099-B or 1099-S (or substitute statement) that you are including on line 2, 10, or 20. See instructions	1	

Part I Sales or Exchanges of Property Used in a Trade or Business and Involuntary Conversions From Other Than Casualty or Theft—Most Property Held More Than 1 Year (see instructions)

2 (a) Description of property	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)	(d) Gross sales price	(e) Depreciation allowed or allowable since acquisition	(f) Cost or other basis, plus improvements and expense of sale	(g) Gain or (loss) Subtract (f) from the sum of (d) and (e)

3	Gain, if any, from Form 4684, line 39	3	
4	Section 1231 gain from installment sales from Form 6252, line 26 or 37	4	
5	Section 1231 gain or (loss) from like-kind exchanges from Form 8824	5	
6	Gain, if any, from line 32, from other than casualty or theft	6	30,000
7	Combine lines 2 through 6. Enter the gain or (loss) here and on the appropriate line as follows	7	30,000
	Partnerships and S corporations. Report the gain or (loss) following the instructions for Form 1065, Schedule K, line 10, or Form 1120-S, Schedule K, line 9. Skip lines 8, 9, 11, and 12 below.		
	Individuals, partners, S corporation shareholders, and all others. If line 7 is zero or a loss, enter the amount from line 7 on line 11 below and skip lines 8 and 9. If line 7 is a gain and you didn't have any prior year section 1231 losses, or they were recaptured in an earlier year, enter the gain from line 7 as a long-term capital gain on the Schedule D filed with your return and skip lines 8, 9, 11, and 12 below.		
8	Nonrecaptured net section 1231 losses from prior years. See instructions	8	
9	Subtract line 8 from line 7. If zero or less, enter -0-. If line 9 is zero, enter the gain from line 7 on line 12 below. If line 9 is more than zero, enter the amount from line 8 on line 12 below and enter the gain from line 9 as a long-term capital gain on the Schedule D filed with your return. See instructions	9	

Part II Ordinary Gains and Losses (see instructions)

10 Ordinary gains and losses not included on lines 11 through 16 (include property held 1 year or less):

11	Loss, if any, from line 7	11	( )
12	Gain, if any, from line 7 or amount from line 8, if applicable	12	
13	Gain, if any, from line 31	13	156,288
14	Net gain or (loss) from Form 4684, lines 31 and 38a	14	
15	Ordinary gain from installment sales from Form 6252, line 25 or 36	15	
16	Ordinary gain or (loss) from like-kind exchanges from Form 8824	16	
17	Combine lines 10 through 16	17	156,288
18	For all except individual returns, enter the amount from line 17 on the appropriate line of your return and skip lines a and b below. For individual returns, complete lines a and b below.		
a	If the loss on line 11 includes a loss from Form 4684, line 35, column (b)(ii), enter that part of the loss here. Enter the loss from income-producing property on Schedule A (Form 1040), line 16. (Do not include any loss on property used as an employee.) Identify as from "Form 4797, line 18a." See instructions	18a	
b	Redetermine the gain or (loss) on line 17 excluding the loss, if any, on line 18a. Enter here and on Schedule 1 (Form 1040), Part I, line 4	18b	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 13086I Form **4797** (2020)

Part III **Gain From Disposition of Property Under Sections 1245, 1250, 1252, 1254, and 1255** (see instructions)

19	(a) Description of section 1245, 1250, 1252, 1254, or 1255 property:	(b) Date acquired (mo., day, yr.)	(c) Date sold (mo., day, yr.)
A	Equipment 1	1/2/17	10/16/20
B			
C			
D			

	These columns relate to the properties on lines 19A through 19D. ▶		Property A	Property B	Property C	Property D
20	Gross sales price (**Note:** *See line 1 before completing.*)	20	280,000			
21	Cost or other basis plus expense of sale	21	250,000			
22	Depreciation (or depletion) allowed or allowable	22	156,288			
23	Adjusted basis. Subtract line 22 from line 21	23	93,712			
24	Total gain. Subtract line 23 from line 20	24	186,288			
25	**If section 1245 property:**					
a	Depreciation allowed or allowable from line 22	25a	156,288			
b	Enter the **smaller** of line 24 or 25a	25b	156,288			
26	**If section 1250 property:** If straight line depreciation was used, enter -0- on line 26g, except for a corporation subject to section 291.					
a	Additional depreciation after 1975. See instructions	26a				
b	Applicable percentage multiplied by the **smaller** of line 24 or line 26a. See instructions	26b				
c	Subtract line 26a from line 24. If residential rental property **or** line 24 isn't more than line 26a, skip lines 26d and 26e	26c				
d	Additional depreciation after 1969 and before 1976	26d				
e	Enter the **smaller** of line 26c or 26d	26e				
f	Section 291 amount (corporations only)	26f				
g	Add lines 26b, 26e, and 26f	26g				
27	**If section 1252 property:** Skip this section if you didn't dispose of farmland or if this form is being completed for a partnership.					
a	Soil, water, and land clearing expenses	27a				
b	Line 27a multiplied by applicable percentage. See instructions	27b				
c	Enter the **smaller** of line 24 or 27b	27c				
28	**If section 1254 property:**					
a	Intangible drilling and development costs, expenditures for development of mines and other natural deposits, mining exploration costs, and depletion. See instructions	28a				
b	Enter the **smaller** of line 24 or 28a	28b				
29	**If section 1255 property:**					
a	Applicable percentage of payments excluded from income under section 126. See instructions	29a				
b	Enter the **smaller** of line 24 or 29a. See instructions	29b				

Summary of Part III Gains. Complete property columns A through D through line 29b before going to line 30.

30	Total gains for all properties. Add property columns A through D, line 24	30	186,288
31	Add property columns A through D, lines 25b, 26g, 27c, 28b, and 29b. Enter here and on line 13	31	156,288
32	Subtract line 31 from line 30. Enter the portion from casualty or theft on Form 4684, line 33. Enter the portion from other than casualty or theft on Form 4797, line 6	32	30,000

Part IV **Recapture Amounts Under Sections 179 and 280F(b)(2) When Business Use Drops to 50% or Less** (see instructions)

			(a) Section 179	(b) Section 280F(b)(2)
33	Section 179 expense deduction or depreciation allowable in prior years	33		
34	Recomputed depreciation. See instructions	34		
35	Recapture amount. Subtract line 34 from line 33. See the instructions for where to report	35		

Melodic Musical Sales, Inc.

XX-2022020 2020 Form 1120

Page 1, Line 17 - Taxes and licenses:

Payroll taxes	$ 62,000
State income tax	75,000
Total	$137,000

Page 1, Line 26 - Other deductions:

General insurance	$ 55,000
Utilities	72,000
Legal and accounting fees	50,000
Total	$177,000

Schedule L, Line 14 - Other assets:	**Beginning**	**Ending**
Cash surrender value	$60,000	$ 80,000

Schedule L, Line 18 - Other current liabilities:	**Beginning**	**Ending**
Accrued payroll taxes	$14,880	$ 18,600
Accrued state income taxes	4,500	7,500
Accrued federal income taxes	2,500	77,361
Total	$21,880	$103,461

Schedule L, Line 21 - Other liabilities:	**Beginning**	**Ending**
Net deferred tax liability	$57,394	$167,593

Schedule M-1, Line 4 - Income subject to tax not recorded on books this year:

The gain difference reported here results from the difference between the accumulated tax depreciation ($156,288) and book depreciation ($75,000) on the equipment sold and the resultant difference in book basis and tax basis.

Schedule M-1, Line 5 - Expenses recorded on books, not deducted:

Premiums - Officers' life insurance	$30,000
Bad debt expense ($45,000 – $40,000)	5,000
Total	$35,000

Schedule M-1, Line 8a - Depreciation:

$600,000 Sec. 179 expense + $148,543 MACRS – $152,500 book depreciation

Form 4562, Part III, Line 17 - MACRS deductions for property placed in service before 2020:

Building ($2,000,000 × 0.02564)	$ 51,280
Equipment 1 ($250,000 × 0.1249 x 0.5)	15,613
Equipment 2 ($500,000 × 0.1249)	62,450
Trucks ($100,000 × 0.192)	19,200
Total	$148,543

Form **1120** Department of the Treasury Internal Revenue Service

U.S. Corporation Income Tax Return

For calendar year 2019 or tax year beginning ______, 2019, ending ______, 20 ___

▶ Go to *www.irs.gov/Form1120* for instructions and the latest information.

OMB No. 1545-0123 **2019**

A Check if:
1a Consolidated return (attach Form 851) ☐
b Life/nonlife consolidated return ☐
2 Personal holding co. (attach Sch. PH) ☐
3 Personal service corp. (see instructions) ☐
4 Schedule M-3 attached ☑

TYPE OR PRINT

Name: Permtemp Corporation

Number, street, and room or suite no. If a P.O. box, see instructions.

City or town, state or province, country, and ZIP or foreign postal code

B Employer identification number: XX-1234567

C Date incorporated: 2019

D Total assets (see instructions): $ 16,629,150

E Check if: (1) ☑ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change

Income

1a	Gross receipts or sales	1a	20,000,000		
b	Returns and allowances	1b			
c	Balance. Subtract line 1b from line 1a			1c	20,000,000
2	Cost of goods sold (attach Form 1125-A)			2	15,000,000
3	Gross profit. Subtract line 2 from line 1c			3	5,000,000
4	Dividends and inclusions (Schedule C, line 23)			4	50,000
5	Interest			5	
6	Gross rents			6	
7	Gross royalties			7	
8	Capital gain net income (attach Schedule D (Form 1120))			8	
9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)			9	
10	Other income (see instructions—attach statement)			10	
11	**Total income.** Add lines 3 through 10 ▶			11	5,050,000

Deductions (See instructions for limitations on deductions.)

12	Compensation of officers (see instructions—attach Form 1125-E) ▶			12	
13	Salaries and wages (less employment credits)			13	
14	Repairs and maintenance			14	
15	Bad debts			15	150,000
16	Rents			16	
17	Taxes and licenses			17	
18	Interest (see instructions)			18	475,000
19	Charitable contributions			19	
20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)			20	1,400,000
21	Depletion			21	
22	Advertising			22	
23	Pension, profit-sharing, etc., plans			23	
24	Employee benefit programs			24	
25	Reserved for future use			25	
26	Other deductions (attach statement) Other $3,855,000 + Meals $10,000			26	3,865,000
27	**Total deductions.** Add lines 12 through 26 ▶			27	5,890,000
28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11.			28	(840,000)
29a	Net operating loss deduction (see instructions)	29a			
b	Special deductions (Schedule C, line 24)	29b	25,000		
c	Add lines 29a and 29b			29c	25,000

Tax, Refundable Credits, and Payments

30	**Taxable income.** Subtract line 29c from line 28. See instructions	30	(865,000)
31	Total tax (Schedule J, Part I, line 11)	31	-0-
32	2019 net 965 tax liability paid (Schedule J, Part II, line 12)	32	
33	Total payments, credits, and section 965 net tax liability (Schedule J, Part III, line 23)	33	
34	Estimated tax penalty. See instructions. Check if Form 2220 is attached ▶ ☐	34	
35	**Amount owed.** If line 33 is smaller than the total of lines 31, 32, and 34, enter amount owed	35	
36	**Overpayment.** If line 33 is larger than the total of lines 31, 32, and 34, enter amount overpaid	36	
37	Enter amount from line 36 you want: **Credited to 2020 estimated tax** ▶ **Refunded** ▶	37	

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Signature of officer | Date | ▶ Title

May the IRS discuss this return with the preparer shown below? See instructions. ☐ **Yes** ☐ **No**

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11450Q Form **1120** (2019)

Schedule L Balance Sheets per Books

Assets		Beginning of tax year (a)	(b)	End of tax year (c)	(d)
1	Cash				500,000
2a	Trade notes and accounts receivable			2,000,000	
b	Less allowance for bad debts	( )		(250,000)	1,750,000
3	Inventories				4,000,000
4	U.S. government obligations				
5	Tax-exempt securities (see instructions)				50,000
6	Other current assets (attach statement) Net DTA*				129,150
7	Loans to shareholders				
8	Mortgage and real estate loans				
9	Other investments (attach statement)				1,000,000
10a	Buildings and other depreciable assets			10,000,000	
b	Less accumulated depreciation	( )		(800,000)	9,200,000
11a	Depletable assets				
b	Less accumulated depletion	( )		( )	
12	Land (net of any amortization)				
13a	Intangible assets (amortizable only)				
b	Less accumulated amortization	( )		( )	
14	Other assets (attach statement)				
15	Total assets				16,629,150
	Liabilities and Shareholders' Equity				
16	Accounts payable				2,610,000
17	Mortgages, notes, bonds payable in less than 1 year				
18	Other current liabilities (attach statement)				
19	Loans from shareholders				
20	Mortgages, notes, bonds payable in 1 year or more				8,500,000
21	Other liabilities (attach statement)				
22	Capital stock: a Preferred stock				
	b Common stock			6,000,000	6,000,000
23	Additional paid-in capital				
24	Retained earnings—Appropriated (attach statement)				
25	Retained earnings—Unappropriated				(480,850)
26	Adjustments to shareholders' equity (attach statement)				
27	Less cost of treasury stock		( )		( )
28	Total liabilities and shareholders' equity				16,629,150

Schedule M-1 Reconciliation of Income (Loss) per Books With Income per Return

Note: The corporation may be required to file Schedule M-3. See instructions.

1	Net income (loss) per books See Schedule M-3		7	Income recorded on books this year not included on this return (itemize): Tax-exempt interest $	
2	Federal income tax per books				
3	Excess of capital losses over capital gains				
4	Income subject to tax not recorded on books this year (itemize):				
5	Expenses recorded on books this year not deducted on this return (itemize):		8	Deductions on this return not charged against book income this year (itemize):	
a	Depreciation $		a	Depreciation $	
b	Charitable contributions $		b	Charitable contributions $	
c	Travel and entertainment $				
			9	Add lines 7 and 8	
6	Add lines 1 through 5		10	Income (page 1, line 28)—line 6 less line 9	

Schedule M-2 Analysis of Unappropriated Retained Earnings per Books (Line 25, Schedule L)

1	Balance at beginning of year	-0-	5	Distributions: a Cash	
2	Net income (loss) per books	(480,850)		b Stock	
3	Other increases (itemize):			c Property	
			6	Other decreases (itemize):	
			7	Add lines 5 and 6	-0-
4	Add lines 1, 2, and 3	(480,850)	8	Balance at end of year (line 4 less line 7)	(480,850)

Form **1120** (2019)

* $255,150 DTA – $126,000 DTL.

SCHEDULE M-3 (Form 1120)
(Rev. December 2019)
Department of the Treasury
Internal Revenue Service

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

▶ Attach to Form 1120 or 1120-C.
▶ Go to *www.irs.gov/Form1120* for instructions and the latest information.

OMB No. 1545-0123

Name of corporation (common parent, if consolidated return): Permtemp Corporation
Employer identification number: XX-1234567

Check applicable box(es): (1) ☑ Non-consolidated return (2) ☐ Consolidated return (Form 1120 only)
(3) ☐ Mixed 1120/L/PC group (4) ☐ Dormant subsidiaries schedule attached

Part I Financial Information and Net Income (Loss) Reconciliation (see instructions)

1a Did the corporation file SEC Form 10-K for its income statement period ending with or within this tax year?
☐ **Yes.** Skip lines 1b and 1c and complete lines 2a through 11 with respect to that SEC Form 10-K.
☑ **No.** Go to line 1b. See instructions if multiple non-tax-basis income statements are prepared.

b Did the corporation prepare a certified audited non-tax-basis income statement for that period?
☐ **Yes.** Skip line 1c and complete lines 2a through 11 with respect to that income statement.
☑ **No.** Go to line 1c.

c Did the corporation prepare a non-tax-basis income statement for that period?
☑ **Yes.** Complete lines 2a through 11 with respect to that income statement.
☐ **No.** Skip lines 2a through 3c and enter the corporation's net income (loss) per its books and records on line 4a.

2a Enter the income statement period: Beginning 01/01/2019 Ending 12/31/2019

b Has the corporation's income statement been restated for the income statement period on line 2a?
☐ **Yes.** (If "Yes," attach an explanation and the amount of each item restated.)
☑ **No.**

c Has the corporation's income statement been restated for any of the five income statement periods immediately preceding the period on line 2a?
☐ **Yes.** (If "Yes," attach an explanation and the amount of each item restated.)
☑ **No.**

3a Is any of the corporation's voting common stock publicly traded?
☐ **Yes.**
☑ **No.** If "No," go to line 4a.

b Enter the symbol of the corporation's primary U.S. publicly traded voting common stock . . . . ☐☐☐☐☐

c Enter the nine-digit CUSIP number of the corporation's primary publicly traded voting common stock . . . . ☐☐☐☐☐☐☐☐☐

4a	Worldwide consolidated net income (loss) from income statement source identified in Part I, line 1 .	**4a**	(480,850)
b	Indicate accounting standard used for line 4a (see instructions): (1) ☑ GAAP (2) ☐ IFRS (3) ☐ Statutory (4) ☐ Tax-basis (5) ☐ Other (specify) ________		
5a	Net income from nonincludible foreign entities (attach statement)	**5a**	( )
b	Net loss from nonincludible foreign entities (attach statement and enter as a positive amount) . . .	**5b**	
6a	Net income from nonincludible U.S. entities (attach statement)	**6a**	( )
b	Net loss from nonincludible U.S. entities (attach statement and enter as a positive amount)	**6b**	
7a	Net income (loss) of other includible foreign disregarded entities (attach statement)	**7a**	
b	Net income (loss) of other includible U.S. disregarded entities (attach statement)	**7b**	
c	Net income (loss) of other includible entities (attach statement)	**7c**	
8	Adjustment to eliminations of transactions between includible entities and nonincludible entities (attach statement)	**8**	
9	Adjustment to reconcile income statement period to tax year (attach statement)	**9**	
10a	Intercompany dividend adjustments to reconcile to line 11 (attach statement)	**10a**	
b	Other statutory accounting adjustments to reconcile to line 11 (attach statement)	**10b**	
c	Other adjustments to reconcile to amount on line 11 (attach statement)	**10c**	
11	**Net income (loss) per income statement of includible corporations.** Combine lines 4 through 10 .	**11**	(480,850)

Note: Part I, line 11, must equal Part II, line 30, column (a) or Schedule M-1, line 1 (see instructions).

12 Enter the total amount (not just the corporation's share) of the assets and liabilities of all entities included or removed on the following lines.

		Total Assets	Total Liabilities
a	Included on Part I, line 4 . . . . ▶	16,629,150	11,110,000
b	Removed on Part I, line 5 . . . . ▶		
c	Removed on Part I, line 6 . . . . ▶		
d	Included on Part I, line 7 . . . . ▶		

For Paperwork Reduction Act Notice, see the Instructions for Form 1120. Cat. No. 37961C **Schedule M-3 (Form 1120) (Rev. 12-2019)**

Schedule M-3 (Form 1120) (Rev. 12-2019) Page **2**

Name of corporation (common parent, if consolidated return): Permtemp Corporation

Employer identification number: XX-1234567

Check applicable box(es): (1) ☐ Consolidated group (2) ☐ Parent corp (3) ☐ Consolidated eliminations (4) ☐ Subsidiary corp (5) ☐ Mixed 1120/L/PC group

Check if a sub-consolidated: (6) ☐ 1120 group (7) ☐ 1120 eliminations

Name of subsidiary (if consolidated return)

Employer identification number

Part II **Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return** (see instructions)

Income (Loss) Items (Attach statements for lines 1 through 12)	(a) Income (Loss) per Income Statement	(b) Temporary Difference	(c) Permanent Difference	(d) Income (Loss) per Tax Return
1 Income (loss) from equity method foreign corporations				
2 Gross foreign dividends not previously taxed				
3 Subpart F, QEF, and similar income inclusions				
4 Gross-up for foreign taxes deemed paid				
5 Gross foreign distributions previously taxed				
6 Income (loss) from equity method U.S. corporations				
7 U.S. dividends not eliminated in tax consolidation	50,000			50,000
8 Minority interest for includible corporations				
9 Income (loss) from U.S. partnerships				
10 Income (loss) from foreign partnerships				
11 Income (loss) from other pass-through entities				
12 Items relating to reportable transactions				
13 Interest income (see instructions) T-E interest	15,000		(15,000)	-0-
14 Total accrual to cash adjustment				
15 Hedging transactions				
16 Mark-to-market income (loss)				
17 Cost of goods sold (see instructions)	(15,000,000)			(15,000,000)
18 Sale versus lease (for sellers and/or lessors)				
19 Section 481(a) adjustments				
20 Unearned/deferred revenue				
21 Income recognition from long-term contracts				
22 Original issue discount and other imputed interest				
23a Income statement gain/loss on sale, exchange, abandonment, worthlessness, or other disposition of assets other than inventory and pass-through entities				
b Gross capital gains from Schedule D, excluding amounts from pass-through entities				
c Gross capital losses from Schedule D, excluding amounts from pass-through entities, abandonment losses, and worthless stock losses				
d Net gain/loss reported on Form 4797, line 17, excluding amounts from pass-through entities, abandonment losses, and worthless stock losses				
e Abandonment losses				
f Worthless stock losses (attach statement)				
g Other gain/loss on disposition of assets other than inventory				
24 Capital loss limitation and carryforward used				
25 Other income (loss) items with differences (attach statement)				
26 **Total income (loss) items.** Combine lines 1 through 25	(14,935,000)		(15,000)	(14,950,000)
27 **Total expense/deduction items** (from Part III, line 39)	(1,690,850)	(250,000)	(94,150)	(2,035,000)
28 Other items with no differences *	16,145,000			16,145,000
29a Mixed groups, see instructions. All others, combine lines 26 through 28	(480,850)	(250,000)	(109,150)	(840,000)
b PC insurance subgroup reconciliation totals				
c Life insurance subgroup reconciliation totals				
30 **Reconciliation totals.** Combine lines 29a through 29c	(480,850)	(250,000)	(109,150)	(840,000)

Note: Line 30, column (a), must equal Part I, line 11, and column (d) must equal Form 1120, page 1, line 28.

Schedule M-3 (Form 1120) (Rev. 12-2019)

*Sales $20,000,000 - Other expenses $3,855,000

Schedule M-3 (Form 1120) (Rev. 12-2019) Page 3

Name of corporation (common parent, if consolidated return): Permtemp Corporation

Employer identification number: XX-1234567

Check applicable box(es): (1) ☐ Consolidated group (2) ☐ Parent corp (3) ☐ Consolidated eliminations (4) ☐ Subsidiary corp (5) ☐ Mixed 1120/L/PC group

Check if a sub-consolidated: (6) ☐ 1120 group (7) ☐ 1120 eliminations

Name of subsidiary (if consolidated return)

Employer identification number

Part III **Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return—Expense/Deduction Items** (see instructions)

Expense/Deduction Items	(a) Expense per Income Statement	(b) Temporary Difference	(c) Permanent Difference	(d) Deduction per Tax Return
1 U.S. current income tax expense				
2 U.S. deferred income tax expense	(129,150)		129,150	
3 State and local current income tax expense				
4 State and local deferred income tax expense				
5 Foreign current income tax expense (other than foreign withholding taxes)				
6 Foreign deferred income tax expense				
7 Foreign withholding taxes				
8 Interest expense (see instructions)	475,000			475,000
9 Stock option expense				
10 Other equity-based compensation				
11 Meals and entertainment	45,000		(35,000)	10,000
12 Fines and penalties				
13 Judgments, damages, awards, and similar costs				
14 Parachute payments				
15 Compensation with section 162(m) limitation				
16 Pension and profit-sharing				
17 Other post-retirement benefits				
18 Deferred compensation				
19 Charitable contribution of cash and tangible property	100,000	(100,000)		-0-
20 Charitable contribution of intangible property				
21 Charitable contribution limitation/carryforward				
22 Domestic production activities deduction (see instructions)				
23 Current year acquisition or reorganization investment banking fees				
24 Current year acquisition or reorganization legal and accounting fees				
25 Current year acquisition/reorganization other costs				
26 Amortization/impairment of goodwill				
27 Amortization of acquisition, reorganization, and start-up costs				
28 Other amortization or impairment write-offs				
29 Reserved				
30 Depletion				
31 Depreciation	800,000	600,000		1,400,000
32 Bad debt expense	400,000	(250,000)		150,000
33 Corporate owned life insurance premiums				
34 Purchase versus lease (for purchasers and/or lessees)				
35 Research and development costs				
36 Section 118 exclusion (attach statement)				
37 Section 162(r)—FDIC premiums paid by certain large financial institutions (see instructions)				
38 Other expense/deduction items with differences (attach statement)				
39 **Total expense/deduction items.** Combine lines 1 through 38. Enter here and on Part II, line 27, reporting positive amounts as negative and negative amounts as positive	1,690,850	250,000	94,150	2,035,000

Schedule M-3 (Form 1120) (Rev. 12-2019)

Permtemp Corporation
Deferred Tax Accounting 2019

Deferred Tax Assets	End of 2019
Net operating loss	$ 865,000
Charitable contributions carryover*	100,000
Net accounts receivable**	250,000
Total deductible temporary difference	$1,215,000
Times: Tax rate	0.21
Deferred tax asset	$ 255,150

*Charitable contributions not deductible this year because of limitation

**$2,000,000 tax basis – $1,750,000 book basis

Deferred Tax Liability:

Net fixed assets*	$600,000
Times: Tax rate	0.21
Deferred tax liability	$126,000

*$9,200,000 book basis – $8,600,000 tax basis

Journal Entry:

Deferred tax asset	255,150	
Deferred tax liability		126,000
Federal income tax benefit		129,150

Adjusted Income Statement (Partial):

Net loss before federal income benefit	$(610,000)
Plus: Federal income tax benefit	129,150
Net loss per books	$(480,850)
Effective tax rate [$(129,150)/$(610,000)]	21.172%

Tax Rate Reconciliation:

Statutory tax rate	21.000%
Nondeductible M&E expense [$35,000/($(610,000) × 21%)]	(1.205)%
Tax-exempt income [$(15,000)/$(610,000) × 21%]	0.516%
Dividends-received deduction [$(25,000)/$(610,000) × 21%]	0.861%
Effective tax rate	21.172%

Permtemp Corporation
Deferred Tax Accounting 2019

Provision Reconciliation:

Net loss before federal income taxes	$ (610,000)
Permanent differences:	
Nondeductible M&E expense	35,000
Tax-exempt income	(15,000)
Dividends-received deduction	(25,000)
Net loss after permanent differences	$ (615,000)
Temporary differences:	
Bad debt expense	250,000
Charitable contribution deduction	100,000
Depreciation	(600,000)
Net operating loss	$ (865,000)

Adjusted Book Balance Sheet:

Cash		$ 500,000
Accounts receivable	$ 2,000,000	
Minus: Allowance for doubtful accounts	(250,000)	1,750,000
Inventory		4,000,000
Net deferred tax asset ($255,150 – $126,000)		129,150
Fixed assets	$10,000,000	
Minus: Accumulated depreciation	(800,000)	9,200,000
Investment in corporate stock		1,000,000
Investment in tax-exempt bonds		50,000
Total assets		$16,629,150
Accounts payable		$ 2,610,000
Long-term debt		8,500,000
Common stock		6,000,000
Retained earnings		(480,850)
Total liabilities and equity		$16,629,150

Form **1120** Department of the Treasury Internal Revenue Service

U.S. Corporation Income Tax Return

For calendar year 2020 or tax year beginning __________, 2020, ending __________, 20 ____

▶ Go to *www.irs.gov/Form1120* for instructions and the latest information.

OMB No. 1545-0123 **2020**

A Check if:
1a Consolidated return (attach Form 851) ☐
b Life/nonlife consolidated return ☐
2 Personal holding co. (attach Sch. PH) ☐
3 Personal service corp. (see instructions) ☐
4 Schedule M-3 attached ☑

TYPE OR PRINT

Name: Permtemp Corporation
Number, street, and room or suite no. If a P.O. box, see instructions.
City or town, state or province, country, and ZIP or foreign postal code

B Employer identification number: XX-1234567
C Date incorporated: 2019
D Total assets (see instructions): $ 20,425,000

E Check if: (1) ☐ Initial return (2) ☐ Final return (3) ☐ Name change (4) ☐ Address change

Income	1a	Gross receipts or sales	1a	33,000,000		
	b	Returns and allowances	1b			
	c	Balance. Subtract line 1b from line 1a			1c	33,000,000
	2	Cost of goods sold (attach Form 1125-A)			2	22,000,000
	3	Gross profit. Subtract line 2 from line 1c			3	11,000,000
	4	Dividends and inclusions (Schedule C, line 23)			4	55,000
	5	Interest			5	
	6	Gross rents			6	
	7	Gross royalties			7	
	8	Capital gain net income (attach Schedule D (Form 1120))			8	
	9	Net gain or (loss) from Form 4797, Part II, line 17 (attach Form 4797)			9	
	10	Other income (see instructions—attach statement)			10	
	11	**Total income.** Add lines 3 through 10 ▶			11	11,055,000
Deductions (See instructions for limitations on deductions.)	12	Compensation of officers (see instructions—attach Form 1125-E) ▶			12	
	13	Salaries and wages (less employment credits)			13	
	14	Repairs and maintenance			14	
	15	Bad debts			15	425,000
	16	Rents			16	
	17	Taxes and licenses			17	
	18	Interest (see instructions)			18	455,000
	19	Charitable contributions			19	140,000
	20	Depreciation from Form 4562 not claimed on Form 1125-A or elsewhere on return (attach Form 4562)			20	2,450,000
	21	Depletion			21	
	22	Advertising			22	
	23	Pension, profit-sharing, etc., plans			23	
	24	Employee benefit programs			24	
	25	Reserved for future use			25	
	26	Other deductions (attach statement) Other $4,675,000 + meals $10,000			26	4,685,000
	27	**Total deductions.** Add lines 12 through 26 ▶			27	8,155,000
	28	Taxable income before net operating loss deduction and special deductions. Subtract line 27 from line 11.			28	2,900,000
	29a	Net operating loss deduction (see instructions)	29a	865,000		
	b	Special deductions (Schedule C, line 24)	29b	27,500		
	c	Add lines 29a and 29b			29c	892,500
Tax, Refundable Credits, and Payments	30	**Taxable income.** Subtract line 29c from line 28. See instructions			30	2,007,500
	31	Total tax (Schedule J, Part I, line 11)			31	421,575
	32	2020 net 965 tax liability paid (Schedule J, Part II, line 12)			32	
	33	Total payments, credits, and section 965 net tax liability (Schedule J, Part III, line 23)			33	
	34	Estimated tax penalty. See instructions. Check if Form 2220 is attached ▶ ☐			34	
	35	**Amount owed.** If line 33 is smaller than the total of lines 31, 32, and 34, enter amount owed			35	
	36	**Overpayment.** If line 33 is larger than the total of lines 31, 32, and 34, enter amount overpaid			36	
	37	Enter amount from line 36 you want: **Credited to 2021 estimated tax** ▶		**Refunded** ▶	37	

Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete. Declaration of preparer (other than taxpayer) is based on all information of which preparer has any knowledge.

▶ Signature of officer | Date | ▶ Title

May the IRS discuss this return with the preparer shown below? See instructions. ☐ **Yes** ☐ **No**

Paid Preparer Use Only

Print/Type preparer's name	Preparer's signature	Date	Check ☐ if self-employed	PTIN
Firm's name ▶			Firm's EIN ▶	
Firm's address ▶			Phone no.	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 11450Q Form **1120** (2020)

Schedule L — Balance Sheets per Books

Assets		Beginning of tax year (a)	(b)	End of tax year (c)	(d)
1	Cash		500,000		2,125,000
2a	Trade notes and accounts receivable	2,000,000		3,300,000	
b	Less allowance for bad debts	(250,000)	1,750,000	(450,000)	2,850,000
3	Inventories		4,000,000		6,000,000
4	U.S. government obligations				
5	Tax-exempt securities (see instructions)		50,000		50,000
6	Other current assets (attach statement) Net DTA[a]		129,150		
7	Loans to shareholders				
8	Mortgage and real estate loans				
9	Other investments (attach statement)		1,000,000		1,000,000
10a	Buildings and other depreciable assets	10,000,000		10,000,000	
b	Less accumulated depreciation	(800,000)	9,200,000	(1,600,000)	8,400,000
11a	Depletable assets				
b	Less accumulated depletion	( )		( )	
12	Land (net of any amortization)				
13a	Intangible assets (amortizable only)				
b	Less accumulated amortization	( )		( )	
14	Other assets (attach statement)				
15	Total assets		16,629,150		20,425,000
	Liabilities and Shareholders' Equity				
16	Accounts payable		2,610,000		2,120,000
17	Mortgages, notes, bonds payable in less than 1 year				
18	Other current liabilities (attach statement) Taxes payable				421,575
19	Loans from shareholders				
20	Mortgages, notes, bonds payable in 1 year or more		8,500,000		8,500,000
21	Other liabilities (attach statement) Net DTL[b]				378,000
22	Capital stock: a Preferred stock				
	b Common stock	6,000,000	6,000,000	6,000,000	6,000,000
23	Additional paid-in capital				
24	Retained earnings—Appropriated (attach statement)				
25	Retained earnings—Unappropriated		(480,850)		3,005,425
26	Adjustments to shareholders' equity (attach statement)				
27	Less cost of treasury stock		( )		( )
28	Total liabilities and shareholders' equity		16,629,150		20,425,000

Schedule M-1 — Reconciliation of Income (Loss) per Books With Income per Return

Note: The corporation may be required to file Schedule M-3. See instructions.

1	Net income (loss) per books See Schedule M-3		7	Income recorded on books this year not included on this return (itemize): Tax-exempt interest $	
2	Federal income tax per books				
3	Excess of capital losses over capital gains				
4	Income subject to tax not recorded on books this year (itemize):		8	Deductions on this return not charged against book income this year (itemize):	
5	Expenses recorded on books this year not deducted on this return (itemize):		a	Depreciation $	
a	Depreciation $		b	Charitable contributions $	
b	Charitable contributions $				
c	Travel and entertainment $				
			9	Add lines 7 and 8	
6	Add lines 1 through 5		10	Income (page 1, line 28)—line 6 less line 9	

Schedule M-2 — Analysis of Unappropriated Retained Earnings per Books (Schedule L, Line 25)

1	Balance at beginning of year	(480,850)	5	Distributions: a Cash	
2	Net income (loss) per books	3,486,275		b Stock	
3	Other increases (itemize):			c Property	
			6	Other decreases (itemize):	
			7	Add lines 5 and 6	-0-
4	Add lines 1, 2, and 3	3,005,425	8	Balance at end of year (line 4 less line 7)	3,005,425

Form **1120** (2020)

[a] $255,150 DTA - $126,000 DTL.

[b] $472,500 DTL - $94,500 DTA.

SCHEDULE M-3 (Form 1120)
(Rev. December 2019)
Department of the Treasury
Internal Revenue Service

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

▶ Attach to Form 1120 or 1120-C.
▶ Go to *www.irs.gov/Form1120* for instructions and the latest information.

OMB No. 1545-0123

Name of corporation (common parent, if consolidated return): Permtemp Corporation

Employer identification number: XX-1234567

Check applicable box(es): (1) ☑ Non-consolidated return (2) ☐ Consolidated return (Form 1120 only)
(3) ☐ Mixed 1120/L/PC group (4) ☐ Dormant subsidiaries schedule attached

Part I Financial Information and Net Income (Loss) Reconciliation (see instructions)

1a Did the corporation file SEC Form 10-K for its income statement period ending with or within this tax year?
☐ **Yes.** Skip lines 1b and 1c and complete lines 2a through 11 with respect to that SEC Form 10-K.
☑ **No.** Go to line 1b. See instructions if multiple non-tax-basis income statements are prepared.

b Did the corporation prepare a certified audited non-tax-basis income statement for that period?
☐ **Yes.** Skip line 1c and complete lines 2a through 11 with respect to that income statement.
☑ **No.** Go to line 1c.

c Did the corporation prepare a non-tax-basis income statement for that period?
☑ **Yes.** Complete lines 2a through 11 with respect to that income statement.
☐ **No.** Skip lines 2a through 3c and enter the corporation's net income (loss) per its books and records on line 4a.

2a Enter the income statement period: Beginning 01/01/2020 Ending 12/31/2020

b Has the corporation's income statement been restated for the income statement period on line 2a?
☐ **Yes.** (If "Yes," attach an explanation and the amount of each item restated.)
☑ **No.**

c Has the corporation's income statement been restated for any of the five income statement periods immediately preceding the period on line 2a?
☐ **Yes.** (If "Yes," attach an explanation and the amount of each item restated.)
☑ **No.**

3a Is any of the corporation's voting common stock publicly traded?
☐ **Yes.**
☑ **No.** If "No," go to line 4a.

b Enter the symbol of the corporation's primary U.S. publicly traded voting common stock . . . .

c Enter the nine-digit CUSIP number of the corporation's primary publicly traded voting common stock . . . .

4a	Worldwide consolidated net income (loss) from income statement source identified in Part I, line 1 .	**4a**	3,486,275
b	Indicate accounting standard used for line 4a (see instructions): (1) ☑ GAAP (2) ☐ IFRS (3) ☐ Statutory (4) ☐ Tax-basis (5) ☐ Other (specify)		
5a	Net income from nonincludible foreign entities (attach statement)	**5a**	( )
b	Net loss from nonincludible foreign entities (attach statement and enter as a positive amount) . . .	**5b**	
6a	Net income from nonincludible U.S. entities (attach statement)	**6a**	( )
b	Net loss from nonincludible U.S. entities (attach statement and enter as a positive amount)	**6b**	
7a	Net income (loss) of other includible foreign disregarded entities (attach statement)	**7a**	
b	Net income (loss) of other includible U.S. disregarded entities (attach statement)	**7b**	
c	Net income (loss) of other includible entities (attach statement)	**7c**	
8	Adjustment to eliminations of transactions between includible entities and nonincludible entities (attach statement)	**8**	
9	Adjustment to reconcile income statement period to tax year (attach statement)	**9**	
10a	Intercompany dividend adjustments to reconcile to line 11 (attach statement)	**10a**	
b	Other statutory accounting adjustments to reconcile to line 11 (attach statement)	**10b**	
c	Other adjustments to reconcile to amount on line 11 (attach statement)	**10c**	
11	**Net income (loss) per income statement of includible corporations.** Combine lines 4 through 10 .	**11**	3,486,275

Note: Part I, line 11, must equal Part II, line 30, column (a) or Schedule M-1, line 1 (see instructions).

12 Enter the total amount (not just the corporation's share) of the assets and liabilities of all entities included or removed on the following lines.

		Total Assets	Total Liabilities
a	Included on Part I, line 4 . . . . ▶	20,425,000	11,419,575
b	Removed on Part I, line 5 . . . . ▶		
c	Removed on Part I, line 6 . . . . ▶		
d	Included on Part I, line 7 . . . . ▶		

For Paperwork Reduction Act Notice, see the Instructions for Form 1120. Cat. No. 37961C **Schedule M-3 (Form 1120) (Rev. 12-2019)**

Name of corporation (common parent, if consolidated return): Permtemp Corporation

Employer identification number: XX-1234567

Check applicable box(es): (1) ☐ Consolidated group (2) ☐ Parent corp (3) ☐ Consolidated eliminations (4) ☐ Subsidiary corp (5) ☐ Mixed 1120/L/PC group

Check if a sub-consolidated: (6) ☐ 1120 group (7) ☐ 1120 eliminations

Name of subsidiary (if consolidated return)

Employer identification number

Part II Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return (see instructions)

Income (Loss) Items (Attach statements for lines 1 through 12)	(a) Income (Loss) per Income Statement	(b) Temporary Difference	(c) Permanent Difference	(d) Income (Loss) per Tax Return
1 Income (loss) from equity method foreign corporations				
2 Gross foreign dividends not previously taxed				
3 Subpart F, QEF, and similar income inclusions				
4 Gross-up for foreign taxes deemed paid				
5 Gross foreign distributions previously taxed				
6 Income (loss) from equity method U.S. corporations				
7 U.S. dividends not eliminated in tax consolidation	55,000			55,000
8 Minority interest for includible corporations				
9 Income (loss) from U.S. partnerships				
10 Income (loss) from foreign partnerships				
11 Income (loss) from other pass-through entities				
12 Items relating to reportable transactions				
13 Interest income (see instructions) T-E interest	15,000		15,000	-0-
14 Total accrual to cash adjustment				
15 Hedging transactions				
16 Mark-to-market income (loss)				
17 Cost of goods sold (see instructions)	(22,000,000)			(22,000,000)
18 Sale versus lease (for sellers and/or lessors)				
19 Section 481(a) adjustments				
20 Unearned/deferred revenue				
21 Income recognition from long-term contracts				
22 Original issue discount and other imputed interest				
23a Income statement gain/loss on sale, exchange, abandonment, worthlessness, or other disposition of assets other than inventory and pass-through entities				
b Gross capital gains from Schedule D, excluding amounts from pass-through entities				
c Gross capital losses from Schedule D, excluding amounts from pass-through entities, abandonment losses, and worthless stock losses				
d Net gain/loss reported on Form 4797, line 17, excluding amounts from pass-through entities, abandonment losses, and worthless stock losses				
e Abandonment losses				
f Worthless stock losses (attach statement)				
g Other gain/loss on disposition of assets other than inventory				
24 Capital loss limitation and carryforward used				
25 Other income (loss) items with differences (attach statement)				
26 **Total income (loss) items.** Combine lines 1 through 25	(21,930,000)	-0-	(15,000)	(21,945,000)
27 **Total expense/deduction items** (from Part III, line 39)	(2,908,725)	(1,550,000)	978,725	(3,480,000)
28 Other items with no differences *	28,325,000			28,325,000
29a Mixed groups, see instructions. All others, combine lines 26 through 28	3,486,275	(1,550,000)	963,725	2,900,000
b PC insurance subgroup reconciliation totals				
c Life insurance subgroup reconciliation totals				
30 **Reconciliation totals.** Combine lines 29a through 29c	3,486,275	(1,550,000)	963,725	2,900,000

Note: Line 30, column (a), must equal Part I, line 11, and column (d) must equal Form 1120, page 1, line 28.

*$33,000,000 sales-$4,675,000 other expenses.

Name of corporation (common parent, if consolidated return): Permtemp Corporation

Employer identification number: XX-1234567

Check applicable box(es): (1) ☐ Consolidated group (2) ☐ Parent corp (3) ☐ Consolidated eliminations (4) ☐ Subsidiary corp (5) ☐ Mixed 1120/L/PC group

Check if a sub-consolidated: (6) ☐ 1120 group (7) ☐ 1120 eliminations

Name of subsidiary (if consolidated return)

Employer identification number

Part III Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return—Expense/Deduction Items (see instructions)

Expense/Deduction Items	(a) Expense per Income Statement	(b) Temporary Difference	(c) Permanent Difference	(d) Deduction per Tax Return
1 U.S. current income tax expense	421,575		(421,575)	
2 U.S. deferred income tax expense	507,150		(507,150)	
3 State and local current income tax expense				
4 State and local deferred income tax expense				
5 Foreign current income tax expense (other than foreign withholding taxes)				
6 Foreign deferred income tax expense				
7 Foreign withholding taxes				
8 Interest expense (see instructions)	455,000			455,000
9 Stock option expense				
10 Other equity-based compensation				
11 Meals and entertainment	60,000		(50,000)	10,000
12 Fines and penalties				
13 Judgments, damages, awards, and similar costs				
14 Parachute payments				
15 Compensation with section 162(m) limitation				
16 Pension and profit-sharing				
17 Other post-retirement benefits				
18 Deferred compensation				
19 Charitable contribution of cash and tangible property	40,000			40,000
20 Charitable contribution of intangible property				
21 Charitable contribution limitation/carryforward		100,000		100,000
22 Domestic production activities deduction (see instructions)				
23 Current year acquisition or reorganization investment banking fees				
24 Current year acquisition or reorganization legal and accounting fees				
25 Current year acquisition/reorganization other costs				
26 Amortization/impairment of goodwill				
27 Amortization of acquisition, reorganization, and start-up costs				
28 Other amortization or impairment write-offs				
29 Reserved				
30 Depletion				
31 Depreciation	800,000	1,650,000		2,450,000
32 Bad debt expense	625,000	(200,000)		425,000
33 Corporate owned life insurance premiums				
34 Purchase versus lease (for purchasers and/or lessees)				
35 Research and development costs				
36 Section 118 exclusion (attach statement)				
37 Section 162(r)—FDIC premiums paid by certain large financial institutions (see instructions)				
38 Other expense/deduction items with differences (attach statement)				
39 **Total expense/deduction items.** Combine lines 1 through 38. Enter here and on Part II, line 27, reporting positive amounts as negative and negative amounts as positive	2,908,725	1,550,000	(978,725)	3,480,000

Schedule M-3 (Form 1120) (Rev. 12-2019)

Permtemp Corporation
Deferred Tax Accounting 2020

Deferred Tax Assets:

	Beg. of 2020	End of 2020	Change
Net operating loss	$ 865,000	$ -0-	$(865,000)
Charitable contributions carryover	100,000	-0-	(100,000)
Net accounts receivable	250,000	450,000*	200,000
Total deductible temp. diff.	$1,215,000	$450,000	$(765,000)
Times: Tax rate	0.21	0.21	
Deferred tax asset	$ 255,150	$ 94,500	$(160,650)

*$3,300,000 tax basis – $2,850,000 book basis

Deferred Tax Liability:

	Beg. of 2020	End of 2020	Change
Net fixed assets	$600,000	$2,250,000*	$1,650,000
Times: Tax rate	0.21	0.21	
Deferred tax liability	$126,000	$ 472,500	$ 346,500

*$8,400,000 book basis – $6,150,000 tax basis

Journal Entry:

Current federal income tax expense	421,575	
Deferred federal income tax expense	507,150	
Deferred tax asset		160,650
Deferred tax liability		346,500
Federal income tax payable		421,575

Adjusted Income Statement (Partial):

Net income before federal income taxes	$4,415,000
Minus: Federal income tax expense ($421,575 + $507,150)	(928,725)
Net income per books	$3,486,275
Effective tax rate [$928,725/$4,415,000]	21.036%

Tax Rate Reconciliation:

Statutory tax rate	21.000%
Nondeductible M&E expense [$50,000/$4,415,000 × 21%]	0.238%
Tax-exempt income [$(15,000)/$4,415,000 × 21%]	(0.071)%
Dividends-received ded. [$(27,500)/$4,415,000 × 21%]	(0.131)%
Effective tax rate	21.036%

Permtemp Corporation

Deferred Tax Accounting 2020

Provision Reconciliation:

Net income before federal income taxes	$ 4,415,000
Permanent differences:	
Nondeductible M&E expense	50,000
Tax-exempt income	(15,000)
Dividends-received deduction	(27,500)
Net income after permanent differences	$ 4,422,500
Temporary differences:	
Bad debt expense	200,000
Charitable contribution deduction	(100,000)
Depreciation	(1,650,000)
Net operating loss deduction	(865,000)
Taxable income	$ 2,007,500

Adjusted Balance Sheet:

Cash		$ 2,125,000
Accounts receivable	$ 3,300,000	
Minus: Allowance for doubtful accounts	(450,000)	2,850,000
Inventory		6,000,000
Fixed assets	$10,000,000	
Minus: Accumulated depreciation	(1,600,000)	8,400,000
Investment in corporate stock		1,000,000
Investment in tax-exempt bonds		50,000
Total assets		$20,425,000
Accounts payable		$ 2,120,000
Federal income tax payable		421,575
Long-term debt		8,500,000
Net deferred tax liability ($472,500 – $94,500)		378,000
Common stock		6,000,000
Retained earnings [$(480,850) + $3,486,275]		3,005,425
Total liabilities and equity		$20,425,000

Alpha Corporation

Form 1120 (2020) Page **6**

Schedule L — Balance Sheets per Books

	Assets	Beginning of tax year (a)	Beginning of tax year (b)	End of tax year (c)	End of tax year (d)
1	Cash				
2a	Trade notes and accounts receivable				
b	Less allowance for bad debts	( )		( )	
3	Inventories				
4	U.S. government obligations				
5	Tax-exempt securities (see instructions)				
6	Other current assets (attach statement)				
7	Loans to shareholders				
8	Mortgage and real estate loans				
9	Other investments (attach statement)				
10a	Buildings and other depreciable assets				
b	Less accumulated depreciation	( )		( )	
11a	Depletable assets				
b	Less accumulated depletion	( )		( )	
12	Land (net of any amortization)				
13a	Intangible assets (amortizable only)				
b	Less accumulated amortization	( )		( )	
14	Other assets (attach statement)				
15	Total assets				
	Liabilities and Shareholders' Equity				
16	Accounts payable				
17	Mortgages, notes, bonds payable in less than 1 year				
18	Other current liabilities (attach statement)				
19	Loans from shareholders				
20	Mortgages, notes, bonds payable in 1 year or more				
21	Other liabilities (attach statement)				
22	Capital stock: **a** Preferred stock				
	b Common stock				
23	Additional paid-in capital				
24	Retained earnings—Appropriated (attach statement)				
25	Retained earnings—Unappropriated				
26	Adjustments to shareholders' equity (attach statement)				
27	Less cost of treasury stock		( )		( )
28	Total liabilities and shareholders' equity				

Schedule M-1 — Reconciliation of Income (Loss) per Books With Income per Return

Note: The corporation may be required to file Schedule M-3. See instructions.

1	Net income (loss) per books	581,760	7	Income recorded on books this year not included on this return (itemize): Tax-exempt interest $ 10,000	10,000
2	Federal income tax per books	156,240			
3	Excess of capital losses over capital gains	8,000			
4	Income subject to tax not recorded on books this year (itemize):		8	Deductions on this return not charged against book income this year (itemize): **a** Depreciation $ 40,000 **b** Charitable contributions $	40,000
5	Expenses recorded on books this year not deducted on this return (itemize): **a** Depreciation $ **b** Charitable contributions $ 4,000 **c** Travel and entertainment $ *16,000	20,000	9	Add lines 7 and 8	50,000
6	Add lines 1 through 5	766,000	10	Income (page 1, line 28)—line 6 less line 9	716,000

Schedule M-2 — Analysis of Unappropriated Retained Earnings per Books (Schedule L, Line 25)

1	Balance at beginning of year		5	Distributions: **a** Cash	
2	Net income (loss) per books			**b** Stock	
3	Other increases (itemize):			**c** Property	
			6	Other decreases (itemize):	
			7	Add lines 5 and 6	
4	Add lines 1, 2, and 3		8	Balance at end of year (line 4 less line 7)	

*$7,000 interest on loan for T-E bonds + $9,000 insurance premium

Form **1120** (2020)

SCHEDULE M-3 (Form 1120)
(Rev. December 2019)
Department of the Treasury
Internal Revenue Service

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

▶ Attach to Form 1120 or 1120-C.
▶ Go to *www.irs.gov/Form1120* for instructions and the latest information.

OMB No. 1545-0123

Name of corporation (common parent, if consolidated return): Omega Corporation
Employer identification number: XX-1234321

Check applicable box(es): (1) ☑ Non-consolidated return (2) ☐ Consolidated return (Form 1120 only)
(3) ☐ Mixed 1120/L/PC group (4) ☐ Dormant subsidiaries schedule attached

Part I Financial Information and Net Income (Loss) Reconciliation (see instructions)

1a Did the corporation file SEC Form 10-K for its income statement period ending with or within this tax year?
☐ **Yes.** Skip lines 1b and 1c and complete lines 2a through 11 with respect to that SEC Form 10-K.
☑ **No.** Go to line 1b. See instructions if multiple non-tax-basis income statements are prepared.

b Did the corporation prepare a certified audited non-tax-basis income statement for that period?
☐ **Yes.** Skip line 1c and complete lines 2a through 11 with respect to that income statement.
☑ **No.** Go to line 1c.

c Did the corporation prepare a non-tax-basis income statement for that period?
☑ **Yes.** Complete lines 2a through 11 with respect to that income statement.
☐ **No.** Skip lines 2a through 3c and enter the corporation's net income (loss) per its books and records on line 4a.

2a Enter the income statement period: Beginning 01/01/2020 Ending 12/31/2020

b Has the corporation's income statement been restated for the income statement period on line 2a?
☐ **Yes.** (If "Yes," attach an explanation and the amount of each item restated.)
☑ **No.**

c Has the corporation's income statement been restated for any of the five income statement periods immediately preceding the period on line 2a?
☐ **Yes.** (If "Yes," attach an explanation and the amount of each item restated.)
☑ **No.**

3a Is any of the corporation's voting common stock publicly traded?
☐ **Yes.**
☑ **No.** If "No," go to line 4a.

b Enter the symbol of the corporation's primary U.S. publicly traded voting common stock . . . .

c Enter the nine-digit CUSIP number of the corporation's primary publicly traded voting common stock . . . .

4a	Worldwide consolidated net income (loss) from income statement source identified in Part I, line 1 .	4a	331,860
b	Indicate accounting standard used for line 4a (see instructions): (1) ☑ GAAP (2) ☐ IFRS (3) ☐ Statutory (4) ☐ Tax-basis (5) ☐ Other (specify)		
5a	Net income from nonincludible foreign entities (attach statement)	5a	( )
b	Net loss from nonincludible foreign entities (attach statement and enter as a positive amount) . . .	5b	
6a	Net income from nonincludible U.S. entities (attach statement)	6a	( )
b	Net loss from nonincludible U.S. entities (attach statement and enter as a positive amount)	6b	
7a	Net income (loss) of other includible foreign disregarded entities (attach statement)	7a	
b	Net income (loss) of other includible U.S. disregarded entities (attach statement)	7b	
c	Net income (loss) of other includible entities (attach statement)	7c	
8	Adjustment to eliminations of transactions between includible entities and nonincludible entities (attach statement)	8	
9	Adjustment to reconcile income statement period to tax year (attach statement)	9	
10a	Intercompany dividend adjustments to reconcile to line 11 (attach statement)	10a	
b	Other statutory accounting adjustments to reconcile to line 11 (attach statement)	10b	
c	Other adjustments to reconcile to amount on line 11 (attach statement)	10c	
11	**Net income (loss) per income statement of includible corporations.** Combine lines 4 through 10 .	11	331,860

Note: Part I, line 11, must equal Part II, line 30, column (a) or Schedule M-1, line 1 (see instructions).

12 Enter the total amount (not just the corporation's share) of the assets and liabilities of all entities included or removed on the following lines.

	Total Assets	Total Liabilities
a Included on Part I, line 4 . . . . ▶	*	*
b Removed on Part I, line 5 . . . . ▶		
c Removed on Part I, line 6 . . . . ▶		
d Included on Part I, line 7 . . . . ▶		

For Paperwork Reduction Act Notice, see the Instructions for Form 1120. Cat. No. 37961C **Schedule M-3 (Form 1120) (Rev. 12-2019)**

*Information not provided.

Schedule M-3 (Form 1120) (Rev. 12-2019) Page **2**

Name of corporation (common parent, if consolidated return): Omega Corporation

Employer identification number: XX-1234321

Check applicable box(es): **(1)** ☐ Consolidated group **(2)** ☐ Parent corp **(3)** ☐ Consolidated eliminations **(4)** ☐ Subsidiary corp **(5)** ☐ Mixed 1120/L/PC group

Check if a sub-consolidated: **(6)** ☐ 1120 group **(7)** ☐ 1120 eliminations

Name of subsidiary (if consolidated return)

Employer identification number

Part II **Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return** (see instructions)

Income (Loss) Items (Attach statements for lines 1 through 12)	(a) Income (Loss) per Income Statement	(b) Temporary Difference	(c) Permanent Difference	(d) Income (Loss) per Tax Return
1 Income (loss) from equity method foreign corporations				
2 Gross foreign dividends not previously taxed				
3 Subpart F, QEF, and similar income inclusions				
4 Gross-up for foreign taxes deemed paid				
5 Gross foreign distributions previously taxed				
6 Income (loss) from equity method U.S. corporations				
7 U.S. dividends not eliminated in tax consolidation				
8 Minority interest for includible corporations				
9 Income (loss) from U.S. partnerships				
10 Income (loss) from foreign partnerships				
11 Income (loss) from other pass-through entities				
12 Items relating to reportable transactions				
13 Interest income (see instructions)	1,000		(1,000)	-0-
14 Total accrual to cash adjustment				
15 Hedging transactions				
16 Mark-to-market income (loss)				
17 Cost of goods sold (see instructions)	(1,100,000)			(1,100,000)
18 Sale versus lease (for sellers and/or lessors)				
19 Section 481(a) adjustments				
20 Unearned/deferred revenue				
21 Income recognition from long-term contracts				
22 Original issue discount and other imputed interest				
23a Income statement gain/loss on sale, exchange, abandonment, worthlessness, or other disposition of assets other than inventory and pass-through entities	(11,000)[a]	11,000		
b Gross capital gains from Schedule D, excluding amounts from pass-through entities		18,000		18,000
c Gross capital losses from Schedule D, excluding amounts from pass-through entities, abandonment losses, and worthless stock losses		(38,000)		(38,000)
d Net gain/loss reported on Form 4797, line 17, excluding amounts from pass-through entities, abandonment losses, and worthless stock losses				
e Abandonment losses				
f Worthless stock losses (attach statement)				
g Other gain/loss on disposition of assets other than inventory				
24 Capital loss limitation and carryforward used		20,000		20,000
25 Other income (loss) items with differences (attach statement)		(15,000)[b]		(15,000)
26 **Total income (loss) items.** Combine lines 1 through 25	(1,110,000)	(4,000)	(1,000)	(1,115,000)
27 **Total expense/deduction items** (from Part III, line 39)	(238,140)	(36,000)	103,140	(171,000)
28 Other items with no differences	1,680,000[c]			1,680,000
29a Mixed groups, see instructions. All others, combine lines 26 through 28	331,860	(40,000)	102,140	394,000
b PC insurance subgroup reconciliation totals				
c Life insurance subgroup reconciliation totals				
30 **Reconciliation totals.** Combine lines 29a through 29c	331,860	(40,000)	102,140	394,000

Note: Line 30, column (a), must equal Part I, line 11, and column (d) must equal Form 1120, page 1, line 28.

Schedule M-3 (Form 1120) (Rev. 12-2019)

[a] $9,000 installment income – $20,000 loss on stock sales.

[b] NOL carryover.

[c] $1,900,000 sales – $220,000 other business expenses.

Name of corporation (common parent, if consolidated return): Omega Corporation

Employer identification number: XX-1234321

Check applicable box(es): (1) ☐ Consolidated group (2) ☐ Parent corp (3) ☐ Consolidated eliminations (4) ☐ Subsidiary corp (5) ☐ Mixed 1120/L/PC group

Check if a sub-consolidated: (6) ☐ 1120 group (7) ☐ 1120 eliminations

Name of subsidiary (if consolidated return)

Employer identification number

Part III Reconciliation of Net Income (Loss) per Income Statement of Includible Corporations With Taxable Income per Return—Expense/Deduction Items (see instructions)

	Expense/Deduction Items	(a) Expense per Income Statement	(b) Temporary Difference	(c) Permanent Difference	(d) Deduction per Tax Return
1	U.S. current income tax expense	82,740		(82,740)	
2	U.S. deferred income tax expense	8,400		(8,400)	
3	State and local current income tax expense	27,000			27,000
4	State and local deferred income tax expense				
5	Foreign current income tax expense (other than foreign withholding taxes)				
6	Foreign deferred income tax expense				
7	Foreign withholding taxes				
8	Interest expense (see instructions)	18,000		(2,000)	16,000
9	Stock option expense				
10	Other equity-based compensation				
11	Meals and entertainment				
12	Fines and penalties	10,000		(10,000)	-0-
13	Judgments, damages, awards, and similar costs				
14	Parachute payments				
15	Compensation with section 162(m) limitation				
16	Pension and profit-sharing				
17	Other post-retirement benefits				
18	Deferred compensation				
19	Charitable contribution of cash and tangible property				
20	Charitable contribution of intangible property				
21	Charitable contribution limitation/carryforward				
22	Domestic production activities deduction (see instructions)				
23	Current year acquisition or reorganization investment banking fees				
24	Current year acquisition or reorganization legal and accounting fees				
25	Current year acquisition/reorganization other costs				
26	Amortization/impairment of goodwill				
27	Amortization of acquisition, reorganization, and start-up costs				
28	Other amortization or impairment write-offs				
29	Reserved				
30	Depletion				
31	Depreciation	80,000	48,000		128,000
32	Bad debt expense				
33	Corporate owned life insurance premiums				
34	Purchase versus lease (for purchasers and/or lessees)				
35	Research and development costs				
36	Section 118 exclusion (attach statement)				
37	Section 162(r)—FDIC premiums paid by certain large financial institutions (see instructions)				
38	Other expense/deduction items with differences (attach statement) Warr. exp.	12,000	(12,000)		-0-
39	**Total expense/deduction items.** Combine lines 1 through 38. Enter here and on Part II, line 27, reporting positive amounts as negative and negative amounts as positive	238,140	36,000	103,140	171,000