

Federal Tax Test. Chapters 1- 3. Test No. _____
Fall, 2016. The University of North Carolina at Charlotte

Name _____ Row in Class _____

INSTRUCTIONS: This test is "open book," which means you may use your electronic textbook or hard copy textbook during the test. You may also use your lecture notes, your study notes, and teaching materials provided in this class or on the website. Some answers may be rounded to nearest dollar. Use 2016 tax rate schedules when computing federal individual income tax (See next to last page of test). Avoid all appearances of impropriety. If you see any sign of impropriety, please prepare an anonymous note and slide it under the instructor's office door. Assume there is no state income tax.

Do not consider the additional tax imposed by the Affordable Care Act.

Multiple-Choice- 25 questions. (4 points each total: 100)

Failure to follow instructions below will result in a 5 point reduction in your grade.

1. Use a soft-lead pencil

In Spaces Above

2. Enter name in appropriate space above. Write clearly.

3. Enter above the row number for your seat in class.

On the Opscan Sheet:

4. Enter name (last name first) in the area for "NAME."

5. Enter test number (found in upper right hand corner of this page) in the special codes area.

6. Blacken circle containing appropriate letter for each question.

Information for first five questions. Sarah, a single taxpayer, earns a salary of **\$130,000** in 2016. She has no deduction for AGI. She claimed an exemption of \$4,050 and itemized deductions of \$20,950. She also earns \$10,000 in interest from an investment in City of Charlotte bonds in 2016.

1. See information above for Sarah. How much total Social Security and Medicare tax will Sarah's employer withhold from her pay in 2016?

- a. \$9,522 b. \$9,377 c. \$9,087 d. \$9,232 e. Other

2. See information above for Sarah. How much is his federal tax liability before credits for 2016, based on the applicable tax rate schedule (rounded)?

- a. \$31,617 b. \$22,436.75 c. \$25,236.75 d. \$19,671 e. Other

3. See information above for Sarah. What is Sarah's average tax rate?

- a. 20.71% b. 21.98% c. 21.95% d. 21.37% e. Other

4. See information above for Sarah. What is Sarah's current marginal tax rate?

- a. 15% b. 25% c. 28% d. 33% e. 35%

5. See information above for Sarah.

Sarah reported the income and deduction amounts that are identified above.

You discover that Sarah also had a \$10,000 short-term capital gain on a sale of AT&T stock in 2016. How much will her federal income tax before credits increase by including the \$10,000 gain?

- a. \$0 b. \$1,500 c. \$2,000 d. \$2,800 e. Other

6. Dave has the choice between investing in a City of Charlotte bond that pays interest at the rate of **5%** or a Duke Energy, Inc. bond that pays interest at the rate of 6%. Both bonds have the same nontax characteristics and that Dave has a **25%** marginal tax rate. There is no state income tax.

What interest rate does Duke Energy, Inc. need to offer to make Dave indifferent between investing in the two bonds?

- a. 9.124% b. 6.667% c. 8.955% d. 5.970% e. 8.333%

7. Mr. Rich started a corporation on January 1, 2016. His trial balance at the end of the year is presented below. Assume a federal income tax rate of 40% for all years. There is no state income tax.

Rich Corporation Trial Balance – December 31, 2016

Cash	30,000	
Accounts Receivable	80,000	
Equipment-placed in service January 2, 2016	40,000	
Accumulated Depreciation-Straight Line- 4 years		10,000
Capital stock		90,000
Retained Earnings		
Home repair revenue		200,000
Rent expense on business property	10,000	
Advertising expense	5,000	
Depreciation expense	10,000	
Employee salaries and other expenses	125,000	
Totals	300,000	300,000

Assume Mr. Rich works for the corporation and takes a reasonable salary of \$60,000. Mr. Rich's salary is included in the Expense of \$125,000 for "Employee salaries and other expenses" above. If Mr. Rich made a valid election for the corporation to be treated as an S corporation for 2016, how much gross income would he report on his personal income tax for 2016? Assume he has no other income.

- a. \$60,000 b. \$50,000 c. \$100,000 d. \$110,000 e. Other

8. Continue the preceding question for Mr. Rich. Assume the corporation is a C corporation. The company elects to expense the entire cost of the equipment on the 2016 income tax return. How much corporate income tax is due for 2016?

- a. \$0 b. \$8,000 c. \$20,000 d. \$16,000 e. Other

9. Continue the preceding question for Mr. Rich. Assume the corporation is a C corporation. The company elects to expense the entire cost of the equipment on the 2016 income tax return. What is the balance in the deferred income tax liability account at the end of 2016?

- a. \$12,000 b. \$2,000 c. \$4,000 d. \$6,000 e. Other

10. Juanita filed her personal federal income tax return for 2014 on February 10, 2015. She earned a salary of \$100,000 and won \$40,000 on a bet on a football game in 2014. She accidentally omitted the \$40,000 lottery prize. When will the statute of limitations expire for her 2014 tax return?

- a. February 10, 2018. b. April 15, 2018. c. February 10, 2021 d. April 15, 2021

11. Mr. T is age 61, single, and cannot be claimed as a dependent by another taxpayer. He does not have any self-employment income.

He must file a federal income tax return for 2016, if he had gross income of at least:

- a. \$4,050 b. \$10,000 c. \$10,350 d. \$11,850 e. Other

12. Warren filed 2015 tax return on July 5, 2016, without requesting an extension.

His total tax was \$20,000. He had no withholding tax and he made no estimated tax payments.

He paid \$20,000 with return filed on July 5, 2016?

What is the total amount of his failure to file and failure to pay penalties?

- a. \$3,000 b. \$2,000 c. \$1,000 d. \$1,100 e. Other

13. Which of the following factors will enable a client to avoid the accuracy related penalty, even though the IRS disallows an exclusion or deduction? (Assume the return did not contain a disclosure of the relevant facts related to the exclusion or deduction.)

- a. There is a reasonable basis for the treatment of the item by the taxpayer.
 b. There is substantial authority for treatment of the item by the taxpayer.
 c. There is a reasonable possibility the treatment of the item will be sustained.
 d. None of these

14. Your client reported salary income of \$300,000. He paid \$100,000 to his former spouse as required by the divorce decree. You had substantial doubt about whether the payment to the former spouse qualifies as alimony.

You prepared a draft of the return without deducting the alimony.

Your draft return showed income tax before credits of \$77,000.

After discussing the issue with your client, and after conducting additional research, you modified the return to show a deduction of \$100,000 for alimony paid.

The revised tax return showed income tax before credits of \$44,000.

The revised return was filed on time, and the balance due was paid when the return was filed. IRS has audited the return. The IRS proposed a disallowance of the alimony deduction, a deficiency of \$33,000, and an accuracy related penalty.

How much penalty will the IRS propose under section 6662?

- a. \$3,300 b. \$6,600 c. \$10,000 d. \$20,000 e. Other

15. Continue preceding question. You prepared the tax return and charged a fee of \$7,000. What is the amount of penalty under Section 6694 that the IRS may impose on you?

- a. \$3,500 b. \$7,000 c. \$1,750 d. \$3,300 e. Other

16. Your client earned a salary of \$200,000 in 2015 and had adjusted gross income of \$190,000. The client had a tax liability of \$40,000 before credits in 2015.

In 2016, your client earned a salary of \$200,000, and also earned consulting income of \$30,000.

As a result, your client will have a tax liability before credits of \$50,000 for 2016.

Client's employer will withhold income taxes of \$45,000 in 2016. How much estimated tax payments should your client make to avoid a penalty for underpayment of tax?

- a. \$0 b. \$4,000 c. \$5,000 d. \$3,300 e. Other

17. Carolyn is currently considering investing in municipal bonds that earn 4 percent interest, or in taxable bonds issued by the Coca-Cola Company that pay 5 percent.

At what personal marginal income tax rate would she be indifferent between the bonds?

- a. 20% b. 25% c. 33% d. 39.6% e. Other

18. Helen is single, and earns a salary of \$40,000. After taking her exemption and itemized deductions, her taxable income is \$20,000 every year. Helen owns 1,000 shares of Fizbo Inc. stock that she purchased on January 30, 2015. The stock has done well and has appreciated \$10 per share since Helen bought the stock. She is considering selling the stock on January 30, 2016.

How much would she save by holding the stock until February 2, 2016 before selling the stock?

- a. \$0 b. \$1,000 c. \$1,500 d. \$2,000 e. Other

19. On September 17, 2015, Arthur bought IBM stock for \$32,000. On September 2, 2016, Arthur sold stock for \$37,000. He has no other capital asset sale in 2016. Arthur is in the 15% marginal tax rate bracket for ordinary income. What is his federal income tax on the stock sale?

- a. \$ - 0 - b. \$ 500 c. \$ 750 d. \$1,000 e. Other

20. Ronnie is single. He earns a salary of \$100,000 per year and has deductions from AGI of \$20,000 (for his exemption and itemized deductions). He has no other income or deductions, before considering the sale of ABC stock. He bought the ABC for \$20,000 two years ago. The ABC stock is now worth \$10,000. He is considering selling the ABC stock for \$10,000 in 2016. How much income tax will he save on his 2016 federal income tax return as a result of selling this stock?

- a. \$ - 0 - b. \$ 500 c. \$ 750 d. \$2,500 e. Other

No.	An	Test No. 1. Fall, 2016																					
1	D	Total compensation		\$130,000																			
		Amount Subject to both (6.2% and 1.45%)		\$118,500	7.65% \$9,065.25																		
		Amount Subject to Medicare tax (at 1.45%)		\$11,500	1.45% \$166.75																		
					\$9,232.00																		
2	B	Sarah, Single, 2016		Computation																			
		Salary		\$130,000																			
		Exemption \$4,050																					
		Itemized deductions \$20,950		(\$25,000)																			
		Taxable Income		\$105,000																			
		Sarah, Single, 2016		Base	Rate Tax																		
		First layer for this taxpayer		91,150	18,558.75																		
		Top layer for this taxpayer		13,850	28% 3,878.00																		
		Total- Case A		105,000	22,436.75																		
3	D	Average tax rate			21.37%																		
4	C	28%																					
5	D	<table border="1"> <thead> <tr> <th></th> <th></th> <th>Case A</th> </tr> </thead> <tbody> <tr> <td>Income tax from above</td> <td></td> <td>22,436.75</td> </tr> <tr> <td>ST Cap gain</td> <td>10,000</td> <td>28% \$2,800</td> </tr> <tr> <td>Total income tax</td> <td></td> <td>\$25,237</td> </tr> </tbody> </table>						Case A	Income tax from above		22,436.75	ST Cap gain	10,000	28% \$2,800	Total income tax		\$25,237						
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1

2

3

Options, Case A and B
Options, Case A and B

Questions 7, 8, 9
Rich Corporation

Cash	30,000	
Accounts Receivable	80,000	
Equipment-placed in service January 2, 2016	40,000	
Accumulated Depreciation-Straight Line- 4 years		10,000
Capital stock		90,000
Retained Earnings		
Home repair revenue		200,000
Rent expense on business property	10,000	
Advertising expense	5,000	
Depreciation expense	10,000	
Employee salaries and other expenses	125,000	
Totals	300,000	300,000

- 7 D With an S Election, how much gross income will the owner report, assuming the owner's salary of \$60,000 is included in the \$125,000 amount.

Salary	60,000
Flow-through of profit	50,000
Total	110,000

- 8 B **Continue with Rich Corporation**

Assume 40% income tax rate for all years.

The full cost of the equipment is expensed on the tax return.

How much income tax is due for the current year.

GAAP NIBT	50,000
Extra write-off	(30,000)
Taxable income	20,000
Tax Rate	40%
Tax Due	8,000

- 9 A What is the balance in the deferred income tax liability at the end of 2016?

GAAP Book value of equipment	30,000
TAX book value of equipment	0
Difference	30,000
Tax Rate	40%
Balance in deferred tax liability	12,000

- No. Explanation
- 10 D Statute of Limitations period is six years if at least 25% of income is omitted
- 11 C Filing requirement for single person: Minimum income for required filing. Exemption amount plus standard deduction amount.

	2016
Standard Deduction amount	\$6,300
Personal exemption amount	4,050
Filing threshold	\$10,350

- 12 A Compute late filing penalty
- Penalty for failure to file is 5% per month, up to 5 months.
- Penalty for failure to pay is .5% per month. (Max. 25%)
- Failure to file penalty is reduced by failure to pay penalty (.5%)
- In effect, total penalty is 5% per month, for first few months.

Amount Underpaid	\$20,000	April 15	
Rate per month it is late	5.0%	May 15	One month
Penalty per month	\$1,000	June 15	Two months
		July 5	Part of a month
Number of months	3	July 15	Three months
Late payment penalty	\$3,000		

Essentials Textbook page 2-27.

- 13 B See multiple-choice homework no. 42. Also class handout for sec. 6662

14 B

Understatement penalty - Section 6662	
Deficiency	\$33,000
Penalty rate under section 6662	20%
Penalty proposed by the IRS	\$6,600

See multiple-choice homework no. 43

15 A

Penalty is greater of:		
(1) \$1,000, or		\$1,000
(2) 50% of your fee for tax preparation		
Fee for preparing the return	\$7,000	
Amount equal to 50% of your fee		\$3,500
Potential preparer penalty-Section 6694(a)(1)		\$3,500

See multiple-choice homework no. 44

16 A

Penalty-Estimated Tax	Current	Prior
Adjusted Gross Income		\$200,000
Income tax liability	\$50,000	\$40,000
	90%	110%
See Sec. 6654(d)(1)(B), (C)	\$45,000	\$44,000
Amount of withholding	\$45,000	\$45,000

No estimated tax payment is needed to avoid a penalty.

Withholding will equal or exceed 90% of current tax and 110% of prior year tax.

Last year percentage is 110%, because taxpayer has high income.

17 A	Carolyn's Municipal Bond Interest	
	Equivalent taxable rate	
	Municipal Rate	4.0%
	Coca Cola bond rate	5.0%
	Additional return	1.0%
	Could pay tax of 1/5 or 20%	20.0%

With 20% tax rate, CocaCola bond would yield 4% after tax.

18 C	Salary		\$40,000
	Exemption and itemized deductions		(\$20,000)
	Taxable income		\$20,000
	Marginal tax rate on ordinary income		15%
		Sell-Jan. 30	Sell Feb. 2
	Amount of gain	\$10,000	\$10,000
	Nature of gain	Short-term	Long-term
	Tax rate applicable to gain	15%	0%
	Tax applicable to gain	\$1,500	\$0
	Savings	\$1,500	

19 C	Arthur's sale of capital asset		
	Date purchased	Sept. 17, 2015	Sept. 17, 2015
	Date sold	Sept. 02, 2016	Sept. 02, 2016
	Nature of gain or loss	Short-term	Short-term
	Selling price	\$37,000	\$37,000
	Cost	\$32,000	\$32,000
	Gain	\$5,000	\$5,000
	Marginal tax rate	15.0%	25.0%
	Federal Income Tax	\$750	\$1,250

This question is same as No. 20 on test no. 1 in 2015, except tax rate was changed here to 15% from 25%.

20 C	Ronnie's sale of capital asset at a loss	
	Date purchased	Two years ago
	Date sold	This year
	Nature of gain or loss	Long-term
	Selling price	\$10,000
	Cost	\$20,000
	Loss on sale of stock	(\$10,000)
	Limit on deduction of a capital loss	(\$3,000)
	Marginal tax rate	25.0%
	Federal Income Tax	(\$750)

Ronne has salary of \$100,000 and deductions of \$20,000.

Thus, he is in the 25% marginal income tax bracket.

This loss reduces ordinary taxable income and saves \$750 this year.

21 A

Ronnie's gift of loss property to daughter	
Date purchased	Two years ago
Date sold	This year
Nature of gain or loss	Long-term
FMV of property on date of gift	\$10,000
Donor's cost (Ronnie's cost)	\$20,000
Daughter's basis for computing gain	\$20,000
Daughter's basis for computing loss	\$10,000
Daughter's selling price	\$10,000
Daughter's gain on sale	\$0
Daughter's loss on sale	\$0

Ronnie could have sold the property at a loss and deducted the loss (subject to limits). Here the loss is lost forever. He should sell the property and give money to daughter.

22 D

Ronnie's gift of appreciated property to daughter	
Date purchased	Two years ago
Date sold	This year
Nature of gain or loss	Long-term C.G.
Daughters taxable income before sale	\$500,000
Daughters marginal tax rate	39.6%
FMV of property on date of gift	\$60,000
Donor's cost (Ronnie's cost)	\$50,000
Daughter's basis for computing gain	\$50,000
Daughter's basis for computing loss	\$50,000
Daughter's selling price	\$60,000
Daughter's capital gain	\$10,000
Daughter's capital gain rate	20.0%
Federal Income Tax	\$2,000

23

24

	Bonus	Dividend
Amount of Bonus or Dividend	\$10,000	\$10,000
Change in Corporate Income Tax		
Amount of extra deduction	\$10,000	\$0
Marginal income tax rate	25.0%	NA
Corporate Tax Savings	\$2,500	NA
Change in Individual Income Tax		
Amount of extra income	\$10,000	\$10,000
Marginal income tax rate - ordinary income	28.0%	
Marginal income tax rate - capital gain rate		15.0%
Extra personal income tax	\$2,800	\$1,500
Net tax savings (added tax) with a bonus	(\$300)	
Net extra tax payment with dividend		(\$1,500)

23 B

24 B

25 A No broken leg

Federal Income Tax Rates-Single - 2016.

Taxable income		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers	Plus	of Taxable Income over:	
0	9,275	0.00	+	10%	0
9,275	37,650	927.50	+	15%	9,275
37,650	91,150	5,183.75	+	25%	37,650
91,150	190,150	18,558.75	+	28%	91,150
190,150	413,350	46,278.75	+	33%	190,150
413,350	415,050	119,934.75	+	35%	413,350
415,050		120,529.75	+	39.6%	415,050

Example: with taxable income of \$9,375, rate is 10% on \$9,275 and 15% on \$100.

Federal Income Tax Rates: Joint - 2016.

Taxable income		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers	Plus	of Taxable Income over:	
0	18,550	0.00	+	10%	0
18,550	75,300	1,855.00	+	15%	18,550
75,300	151,900	10,367.50	+	25%	75,300
151,900	231,450	29,517.50	+	28%	151,900
231,450	413,350	51,791.50	+	33%	231,450
413,350	466,950	111,818.50	+	35%	413,350
466,950		130,578.50	+	39.6%	466,950

Income Tax Rates - Separate - 2016.

Taxable income		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers	Plus	of Taxable Income over:	
0	9,275	0.00	+	10%	0
9,275	37,650	927.50	+	15%	9,275
37,650	75,950	5,183.75	+	25%	37,650
75,950	115,725	14,758.75	+	28%	75,950
115,725	206,675	25,895.75	+	33%	115,725
206,675	233,475	55,909.25	+	35%	206,675
233,475		65,289.25	+	39.6%	233,475

AGI Phase-out Thresholds

Filing Status	Exemptions	Itemized Deduct.
Married, Joint	311,300	311,300
Head-of-Household	285,350	285,350
Single	259,400	259,400
Married, Separate	155,650	155,650

Exemptions reduced by:

2% for each \$2,500 layer above AGI Threshold above (for married filing separately, layer is \$1,250)

Itemized Deductions reduced by lesser of:

3% of excess of AGI over AGI Threshold above

80% of deductions otherwise allowable, except for

Medical Exp., Investment Interest and Casualty losses.

Income Tax Rates - Head of Household - 2016.

Taxable income		Total Federal Income Tax			
Over	But not over	Tax on all Previous Layers	Plus	of Taxable Income over:	
0	13,250	0.00	+	10%	0
13,250	50,400	1,325.00	+	15%	13,250
50,400	130,150	6,897.50	+	25%	50,400
130,150	210,800	26,835.00	+	28%	130,150
210,800	413,350	49,417.00	+	33%	210,800
413,350	441,000	116,258.50	+	35%	413,350
441,000		125,936.00	+	39.6%	441,000

Standard Deduction	Basic	Age/ Blindness
Single	6,300	1,550
Married-Joint	12,600	1,250
Married - File Separately	6,300	1,250
Head of Household	9,300	1,550
Standard deduction for child who is a dependent of another	1,050	
Or: Earned income +	350	
Personal Exemption Amount	4,050	

AMT Exemption	Amount	Phase-out	
Joint Return	83,800	159,700	494,900
Separate Return	41,900	79,850	247,450
H-of-H and Single	53,900	119,700	335,300
AMT Rates (Joint, Head of H., Single)	Amount	Rate	
Rate on AMT base up to	186,300	26%	
Rate on AMT base above	186,300	28%	

OASDI rate on salary up to	\$118,500	6.20%
Medicare rate on salary up to	\$118,500	1.45%
Medicare rate on excess	Excess	1.45%
Extra Medicare - .9%. (Single & HH) Wages above		\$200,000
Extra Medicare - .9%. (Joint) Wages above		\$250,000
NII tax (3.8%) on lesser of NII or AGI (Single & HH) above		\$200,000
NII tax (3.8%) on lesser of NII or AGI (Joint) above		\$250,000

Federal Corporate Income Tax Rates

Taxable Income		of the			
Over	but not over	The tax is:			amount over:
0	50,000	0	+	15%	0
50,000	75,000	7,500	+	25%	50,000
75,000	100,000	13,750	+	34%	75,000
100,000	335,000	22,250	+	39%	100,000
335,000	10,000,000	113,900	+	34%	335,000
10,000,000	15,000,000	3,400,000	+	35%	10,000,000
15,000,000	18,333,333	5,150,000	+	38%	15,000,000
18,333,333				35%	

Case 1. Proprietorship. Case 2 Corporation	Case 1-Prop	Case 2-Corp
Total taxable income from business	\$200,000	\$200,000
Salary to owner	0	(125,000)
Corporate taxable income	NA	\$75,000
Corporate income tax (federal)	NA	\$13,750

Corporate income tax computation			Case 1-Proprietorship	Case 2-Corp.
0	50,000	15%	50,000	7,500
50,000	75,000	25%	25,000	6,250
75,000	100,000	34%	25,000	0
100,000	335,000	39%	100,000	0
Corporate taxable Income and tax			200,000	13,750

Personal Return- Form 1040	Case 1-Prop	Case 2-Corp
Proprietorship income or Corporate salary	\$200,000	\$125,000
Other taxable income (from savings account, etc.)	\$50,000	\$50,000
Total Taxable income	\$250,000	\$175,000

Single-2016-Case 1	Base	Rate	Tax
Lower layer (s)	\$190,150		\$46,279
Top layer	59,850	33%	19,751
Income and Tax	\$250,000		\$66,029

Personal Tax with Proprietorship.

Single-2016- Case 2	Base	Rate	Tax
Lower layer (s)	\$91,150		\$18,559
Top layer for Rich	83,850	28%	23,478
Rich's Income and Tax	\$175,000		\$42,037

Personal Tax with corporation.

Total Income Tax Burden in 2016	Case 1	Case 2	
Corporate Tax	NA	\$13,750	
Individual Tax	66,029	42,037	
Total income tax	\$66,029	\$55,787	(\$10,243) Saving

Individual Income Tax Rates - Single Person - 2016

Individual taxable income:		Total Individual Federal Income Tax - Single			
Over	But Not Over	Tax on all Previous Layers		Plus	of Taxable Income over:
\$0	\$9,275	0.00	+	10%	\$0
9,275	37,650	927.50	+	15%	\$9,275
37,650	91,150	5,183.75	+	25%	\$37,650
91,150	190,150	18,558.75	+	28%	\$91,150
190,150	413,350	46,278.75	+	33%	\$190,150
413,350	415,050	119,934.75	+	35%	\$413,350
\$415,050		120,529.75	+	39.6%	\$415,050

Case 1. She will owe self-employment tax income on \$200,000.

Case 2. She will also owe social security tax on corporate salary.