"We are not a speculator but investor"

ECO 352 Finance
09/27/2018 in-class activity

1. The Cortland corporation had $200,000 of taxable income from operations this year.
a. What is the company's federal income tax bill for the year?
b. Assume that the firm receives an additional $40,000 of interest income from the bond it owns. What is the tax on this interest income?
c. Assume that Cortland does not receive the interest income, but does receive an additional $40,000 in dividends on some stock it owns. What is the tax on this dividend income?

Answer

a. Tax = $22,250 + ($200,000 - $100,000) (0.39) = $61,250.

b. Tax = $40,000(0.39) = $15,600.

d. Tax = ($40,000) (1 – 0.7)(0.39) = $4,680.

2. The red-dragon corporation has a taxable income of $365,000 from operations after all operating costs but before (1) interest charges of $50,000, (2) dividends received of $15,000, (3) dividends paid of $25,000, and (4) income taxes.
A. what is the firm's income tax liability?
B. What is the company's marginal tax rate?
C. What is the firm's average tax rate on taxable income?

Answer:

A.

Income	$365,000	
Less: Interest deduction	(50,000)	
Plus: Dividends received	4,500	= $15,000 x (1 – 0.70) = $4,500
Taxable income	$319,500	

Tax = $22,250 + ($319,500 – $100,000)(0.39) = $22,250 + $85,605 = $107,855.

After-tax income:

Taxable income	$319,500
Taxes	(107,855)
Plus: Non-taxable dividends received*	10,500
Net income	$222,145

B. The company's marginal tax rate is 39 percent.

C. The company's average tax rate is $107,855/$319,500 = 33.76%.