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Valerie Johnston Yudell

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Corporate vs. Partnership Tax Liability Under the Revenue Act of 1942

By VALERIE JOHNSTON YUDELL, C. P. A.

While the writer would not attempt to cheat the United States Government out of its just share of corporate income, she was curious to know how much greater were the taxes of the following close corporation over what they would have been if the business had been carried on as a partnership.

A, B, and C each owned 33 1/3% of the outstanding stock of the D Corporation. Each was married, none had dependents, and none had income from any other source. In 1942, the D Corporation earned \$90,000 entirely from its own operations after paying each of the three officers (A, B, and C) a salary of \$10,000. It had an excess profits tax credit of \$45,000, and paid dividends of \$18,000. Its tax liability is computed as follows:

	TAX
Net Income .....	\$90,000
Less: Excess Profits	
Credit .....	\$45,000
Specific Exemption 5,000	
<u>Total Deduction .....</u>	<u>50,000</u>
Excess profits tax base.....	\$40,000 \$36,000
Net Income .....	\$90,000
Less: Excess profits	
tax base .....	40,000
Normal tax & surtax base....	50,000
Normal tax at 24% .....	12,000
Surtax at 16% .....	8,000
Total Tax Liability of	
D Corporation .....	<u>\$56,000</u>
Tax Liability of each shareholder of D Corporation:	

	TAX
Salary .....	\$10,000
Share of \$18,000 dividends	

Mrs. Yudell is a Chicagoan; graduated from Northwestern University in June 1941 where she was elected to Delta Mu Delta, honorary commerce society, and was winner of the Phi Gamma Nu prize, given to the woman with the highest average in the graduate class. She is a member of the Illinois Society of C.P.A.'s and is employed by Levinson, Becker, Peebles, and Swiren.

paid .....	6,000
Net Income .....	\$16,000
Personal Exemption .....	1,200
Surtax Net Income.....	\$14,800 \$ 3,500
Earned Income Credit	
(10% of \$10,000) .....	1,000
Normal Tax Net Income.....	<u>\$13,800</u> 828
Tax liability of each shareholder-officer .....	<u>\$ 4,328</u>
Total Tax liability of A, B, and C .....	<u>\$12,984</u>
Combined tax liability of D Corporation and its three shareholder-officers .....	<u>\$68,984</u>

If the business had been carried on as a partnership, the tax liability of each partner is computed as follows:

	TAX
Net business income .....	\$90,000
Add back officers salaries .....	30,000
Partnership Net Income .....	\$120,000
Proportionate share of each partner....	\$ 40,000
Personal exemption .....	1,200
Surtax Net Income..	\$ 38,800 \$16,288
Earned Income Credit	
(10% of 20% of \$40,000) .....	800
Normal Tax Net Income .....	<u>\$ 38,000</u> 2,280
Tax liability of each partner .....	<u>\$18,568</u>
Total tax liability of all three partners .....	<u>\$55,704</u>
Tax Saving under partnership form .....	<u>\$13,280</u>