Problem 2-7: Sample solution

The Talley Corporation had 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. What are the firm's income tax liability and its after-tax income. What are the company's marginal and average tax rates on taxable income.

You first need to determine Talley's taxable income:

Income after operating costs: $365,000.00
Less: Interest Expense $-50,000.00
Plus: Taxable Dividends Received $4,500.00
    Only 30% of the $15,000 in dividends are taxable.
Taxable Income: $319,500.00

Next you need to calculate your tax liability from Table 2-6: Corporate Tax Rates as of January 2008, on page 71.

$319,500 falls into the $100,000 to $335,000 bracket so the corporate tax would be:  

\[
\text{Tax Liability} = \frac{\text{Base Amount}}{\text{Marginal Rate}} \times (\text{Taxable Income} - \text{Lower Base})
\]

\[
= \frac{22,250}{.39} \times (319,500 - 100,000)
\]

\[
= 107,855.00
\]

Talley's marginal tax rate is 39% the rate on the last dollar of income subject to tax. Talley's average tax rate is: Tax Liability / Amount of Income Subject to Tax
Average Tax Rate = $107,855 / $319,500 = 33.76%