

Solutions Chapter 2

Exercise 2.1

a.

Proprietorship:

Profit = $20\% \times \$200,000 = \$40,000$

Tax bill = $0.25 \times \$20,000 + 0.45 \times \$20,000 = \$14,000$.

Company:

Corporate Profit = $\$40,000 - \$25,000 = \$15,000$

Tax bill = $0.35 \times \$15,000 + 0.25 \times \$20,000 + 0.45 \times \$5,000 = \$12,500$.

The legal form of a company is better.

b. Tax bill = $0.35 \times \$15,000 + 0.25 \times \$20,000 + 0.45 \times (\$5,000 + \$7,500) = \$15,875$.

The double taxation now makes the proprietorship fiscally more attractive.