
**MIKE'S SPORTING GOODS, INC.
A "C" CORPORATION
1120 RETURN PROJECT**

As the newest member on the corporate tax department team, the senior partner assigns you to prepare corporate tax returns for Mike's Sporting Goods, Inc.

Mike's Sporting Goods, Inc., is a Maryland C-Corporation that sells athletic shoes and clothing to sports teams at the college level. The company was originally started by Mike Jones and three guys he met while attending UMUC, all of whom were state champions in various sports. Juan Delaross was a swimmer who won the state championship with his killer butterfly stroke in the 100-meter fly. Elroy Mulcane was the college champion in golf and Scott Barnett was the state cycling champion three years in a row. Mike won the state championship as a sprinter all four years of college.

Starting the company was Mike's idea, he owns the largest percentage of stock, and is the only owner who works in the business. The other three investors brought money to the table, but never planned on working in the sporting goods store. Therefore, no one questioned Mike when he suggested naming the corporation Mike's Sporting Goods, Inc. In addition, Mike has always had a strong desire to be known as the big guy on campus even after graduation.

Location

As the old saying goes, *Location, location, location*. Luckily, Juan is a commercial real estate broker with a reputation for finding the perfect location for small businesses. After showing the location to the other investors, everyone agreed it would attract their target market of young athletic enthusiasts. As corporate officers, Mike and Juan signed a ten-year lease that required \$9,200 per year in rent.

The building was built just a few years ago, so minimal expense was projected for maintenance and repairs. In 20Y5, Mike kept repairs expense down to \$800, which really pleased Juan, Elroy, and Scott.

Corporate investments

During 20Y5, Mike's Sporting Goods, Inc. received the following investment incomes:

- Interest from its own Accounts Receivables = \$1,500
- Interest from corporate bonds = \$4,000
- Interest from tax-exempt state bonds = \$5,000
- Dividends from various U.S. corporations = \$10,000

- Mike's Sporting Goods, Inc. owns 20% of the stock of one corporation

Since Mike's Sporting Goods, Inc. did not have a net operating loss, its only entry on line 29 is the dividends-received deduction of \$8,000 from Schedule C, page 2.

Year-end 20Y5, includes a \$3,600 capital losses from the sale of securities.

Revenue from Sales

The corporation, which uses an accrual basis of accounting on a calendar year, brought in \$2,910,000 in gross sales in 20Y5. Just less than 1% of gross sales were returned, thus bringing net sales to \$2,890,000. Thanks to Mike's purchasing savvy, cost of goods sold was \$2,050,000, which is less than the industry standard of 80% of sales.

Other Expenses:

Advertising

While the stockholder's had intended on spending more on advertising, Mike only spent \$8,700 and most of it was in Website development.

Bad debt expense

The corporation uses the specific account write off method for uncollectible accounts receivable. A total of \$1,600 in accounts receivable were written off in 20Y5.

Charitable contributions

During the year, Mike's Sporting Goods, Inc. contributed \$11,400 to the UMUC Traveling Athletes Fund and \$12,600 to the UMUC Athletic Scholarship Fund.

Depreciation

On Line 8(a) of the Schedule M of the 1120, Mike's Sporting Goods, Inc. reports the difference between the depreciation claimed on the tax return and the depreciation shown on the corporation's books.

Total depreciation from Form 4562 (not illustrated) is \$17,600. \$12,400 is included as cost of goods sold in Line 5 of the Form 1125-A. Enter the balance of \$5,200 on line 20. Book Depreciation is \$15,980.

Interest expense:

Mike's Sporting Goods, Inc. incurs interest expense on debt to finance operations and to buy investments when a deal is just too good to pass up. Elroy is a securities broker with a national brokerage firm, therefore he handles all corporate investments. In 20Y5, the corporation accrued \$27,200 in interest expense plus \$850 in interest on notes used to carry tax-exempt state bonds.

Salaries

When the corporation was first formed, the four corporate officers agreed to keep their salaries low for the first five years to allow the business to grow. Thus, they agreed to pay Mike \$55,000 per year, since he will manage the store, and \$5,000 per year to the other stockholders. Thereby, total officers salaries will be \$70,000 per year for the first five years. Hint: use Schedule E.

Since Mike will be handling the ordering, inventory management, and other administrative tasks, all employees will be in sales. Given the nature of sporting goods stores, everyone agreed the staff should be college students currently attending UMUC. Their goal was to keep wages below \$50,000 per year. In 20Y5, Mike managed to keep total wages at \$44,000.

All other expenses

All other expenses of operating Mike's Sporting Goods, Inc. totals \$78,300. These expenses include legal fees, office expenses, and sales commissions. Attach a schedule that itemizes these expenses to the return.

Taxes and credits

Taxes:

At December 31, 20Y5, the corporation had \$55,387 in accrued federal income taxes.

Mike's Sporting Goods, Inc. made four estimated tax payments totaling \$69,117 as follows:

- \$17,280 on 4/15/20Y5
- \$17,280 on 6/15/20Y5
- \$17,280 on 9/15/20Y5
- \$17,871 on 1/15/20Y6

See the cancelled checks in Appendix F.

Tax Credits:

The work opportunity credit is an incentive to hire persons from groups with a particularly high unemployment rate or other special employment needs. Given the high unemployment rate of college students, Mike's Sporting Goods, Inc. is eligible for a \$6,000 work opportunity credit. Hint: use Form 5884. The credit will then carry over to the Schedule J of the 1120.

Reconciling Book to Return:

Mike's Sporting Goods, Inc. has the following non-deductible expenses on its Income Statement Per Books:

Premiums paid on term life insurance on corporate officers	\$9,500
Interest paid to purchase tax-exempt state bonds	850
Nondeductible contributions	500
Reduction of salaries by work opportunity credit	<u>6,000</u>
Total	<u>\$16,850</u>

Deductible state and local taxes (not federal income tax) totaled \$15,000

If Mike's Sporting Goods, Inc. owes income tax, the corporation will mail a check; if, otherwise, credit any overpayment to next years estimated taxes.

III. Steps to Completion:

Prepare IRS Form 1120

1. Prepare Schedules M-1: Reconciliation of Income (Loss) per Books with Income per Return using financial data in the Appendices.
2. Prepare Schedule M-2: Analysis of Unappropriated Retained Earnings per Books using financial data in the Appendices.

IV. Deliverables:

The following forms and schedules, combined as a single PDF document, are required:

- Form 1120
- Form 4562: Depreciation and Amortization
- Schedule C: Total Special Deductions
- Schedule D: Net Long-Term Capital Gains or Losses
- Schedule J: Total Tax
- Schedule J: Total Payments and Credits
- Schedule K: Accuracy
- Schedule L: End of Tax Year: Total Liabilities and Stockholder's Equity
- Form 8949: Totals for Proceeds, Basis, & Gain/Loss
- Form 1125-A: Total for Cost of Goods Sold
- Form 3800: General Business Credit: Credit Allowed for the Current Year
- M-1 Income
- M-2 Balance at End of Year
- In addition, each student must separately submit their *Group Contribution Report* in their Assignment folder.

Appendices: Table of Contents

- Appendix A: Basic corporate information
- Appendix B: List of select Accounts and Balances per Book
 - (Financial basis, NOT tax basis)
- Appendix C: Income Statement **per Books**
 - (Financial basis, not tax)
- Appendix D: Comparative Balance Sheet **per Books**
 - (Financial basis, not tax)
- Appendix E: General Ledger Retained Earnings account in T-account format.
- Appendix F: Cancelled checks to the Internal Revenue Service for estimated quarterly tax payments

APPENDIX A: Basic corporate information

Corporate Name	Mike's Sporting Goods, Inc.
Corporate Address	422 Bruce Lane Annapolis, MD 21401
Federal Tax ID	52-9746858
Corporate officers:	
President/CEO	Michael S. Duke
Vice President	Juan Delaross
Treasurer	Elroy Mulcane
Secretary	Scott Barnett

APPENDIX B: List of select Accounts and Balances **per Book** (financial-basis, not tax basis). Account balances may or may not be reported on Form 1120.
Hint: You will need these items to prepare Schedule M of the 1120.

Account	Account Balance
Advertising	8,700
Bad debts	1,600
Charitable Contributions to Not-for-Profit organizations	24,000
Charitable Contributions to political campaigns	500
Compensation of officers	70,000
Cost of goods sold	2,050,000
Depreciation--indirect	3,580
Dividends received	10,000
Federal income tax accrued	55,387
Interest expense on note to buy tax-exempt state bonds	850
Interest expense on note to buy corporate bonds	27,200
Interest income on tax exempt state bonds	5,000
Interest income on taxable corporate bonds	5,500
Loss on securities	3,600
Maintenance and Repairs	800
Net income per books after tax	517,783
Other operating expenses	78,300
Premiums on life insurance	9,500
Proceeds from life insurance	9,500
Rental expense	9,200
Salaries and wages--indirect	44,000
Sales - gross	2,910,000
Sales returns and allowances	20,000
State and Local Taxes	15,000

APPENDIX C: Income Statement **per Book** (financial, not tax)

Mike's Sporting Goods, Inc.			
Income Statement (per Books)			
Year ending 20Y5			
Revenue:			
Gross sales			\$ 2,910,000
Less: Returns & allowances		20,000	
Net sales		2,890,000	
Cost of goods sold		2,050,000	
Gross Margin			840,000
Operating expenses:			
Advertising		8,700	
Bad debt		1,600	
Charitable contributions:			
Deductible	24,000		
Non-deductible	500	24,500	
Depreciation		3,580	
Equipment rental		9,200	
Life insurance		9,500	
Maintenance & repairs		800	
Officers compensation		70,000	
Salaries and wages		44,000	
Total operating expenses			<u>171,880</u>
Operating Income			668,120
Other revenue and gains:			
Dividend income		10,000	
Interest income: Maryland bonds		5,000	
Interest income: All other bonds		5,500	
Proceeds from life insurance		9,500	
Total other revenue and gains			30,000
Other expenses and losses:			
Accrued federal income taxes		55,387	
Other operating expenses		78,300	
Loss on investments		3,600	
Total other expenses and losses			137,287
Total income before interest and taxes			560,833
Interest expense on note to purchase tax-exempt bonds	850		
Interest expense on all other notes	27,200	28,050	
Income before tax			532,783
Less: State & Local Income tax			<u>15,000</u>
Net income per books after tax			<u>517,783</u>

APPENDIX D: Comparative Balance Sheet **per Books** (financial, not tax)

Mike's Sporting Goods, Inc.				
Balance Sheet per Books				
December 31, 20Y4 and 20Y5				
	Year Ending 20Y4		Year ending 20Y5	
Assets				
Cash		114,700		329,564
Accounts receivable (net)		98,400		235,001
Inventory		426,000		495,479
Tax-exempt securities		100,000		120,000
Other current assets		26,300		17,266
Other investments		100,000		80,000
Buildings	272,400		296,700	
Accumulated depreciation	88,300	184,100	104,280	192,420
Land		20,000		20,000
Other assets		14,800		19,300
Total assets		<u>1,084,300</u>		<u>1,509,030</u>
Liabilities & Stockholder's Equity				
Accounts payable		428,500		334,834
Notes payable (short term)		4,300		4,300
Other current liabilities		6,800		7,400
Notes payable (long term)		176,700		264,100
Stockholder's Equity				
Common stock		200,000		200,000
Retained earnings: Appropriated		30,000		40,000
Retained earnings: Unappropriated		<u>238,000</u>		<u>658,396</u>
Total liabilities & Stockholder's equity		<u>1,084,300</u>		<u>1,509,030</u>

APPENDIX E: General ledger Retained Earnings account in T-account format

General Ledger Retained Earnings Account			
Explanations:	Debits	Credits	Explanations:
Contingencies	10,000	238,000	Beg balance
Accrued income tax	55,387	532,783	Net Income before tax
Dividends paid	65,000	18,000	Income tax refund
Ending balance		<u>658,396</u>	

APPENDIX F: Canceled checks

Mike's Sporting Goods, Inc. 422 Bruce Lane Annapolis, MD 21401		1643
		Date: 4/15/20Y5
Pay to the	Internal Revenue Service	\$17,280
Order of:		
Seventeen thousand two hundred eighty		00/100 Dollars
Bank of America Annapolis Mall Branch Annapolis, MD 21401		
For	Estimated quarterly tax payment	Michael S. Duke, President/CEO
00098-00030-006000 0004-090-08000		

Mike's Sporting Goods, Inc. 422 Bruce Lane Annapolis, MD 21401		1679
		Date: 6/15/20Y5
Pay to the	Internal Revenue Service	\$17,280
Order of:		
Seventeen thousand two hundred eighty		00/100 Dollars
Bank of America Annapolis Mall Branch Annapolis, MD 21401		
For	Estimated quarterly tax payment	Michael S. Duke, President/CEO
00098-00030-006000 0004-090-08000		

Mike's Sporting Goods, Inc. 422 Bruce Lane Annapolis, MD 21401		1735
		Date: 9/15/20Y5
Pay to the	Internal Revenue Service	\$17,280
Order of:		
Seventeen thousand two hundred eighty		00/100 Dollars
Bank of America Annapolis Mall Branch Annapolis, MD 21401		
For	Estimated quarterly tax payment	Michael S. Duke, President/CEO
00098-00030-006000 0004-090-08000		

Mike's Sporting Goods, Inc. 422 Bruce Lane Annapolis, MD 21401		1808
		Date: 1/15/20Y6
Pay to the	Internal Revenue Service	\$17,871
Order of:		
Seventeen thousand eight hundred seventy one		00/100 Dollars
Bank of America Annapolis Mall Branch Annapolis, MD 21401		
For	Estimated quarterly tax payment	Michael S. Duke, President/CEO
00098-00030-006000 0004-090-08000		