

Comprehensive Example

Facts:

- ABC Pharmacy, Inc. is an S Corporation
- ABC Pharmacy, Inc. reports financials and tax on accrual basis in 2017
- Bob is a pharmacist and 100% owner of ABC Pharmacy, Inc.
- Bob's cost basis in his pharmacy is \$257,500
- Betty is also a pharmacist and works at ABC Pharmacy, Inc.
- Bob is married to Betty and they file jointly on their personal tax return
- Bob and Betty have no children
- Bob's compensation from the pharmacy is \$120,000
- Betty's compensation from the pharmacy is \$120,000
- ABC Pharmacy, Inc.'s revenue makeup includes 95% prescription sales 3% OTC sales and 2% other services
- The 481(a) adjustment from accrual to cash is \$265,000

ABC Pharmacy, Inc.
Balance Sheet - Accrual Basis
12.31.18

Assets

Cash	\$350,000
AR Third Party	\$300,000
Inventory	\$250,000
Net Fixed Assets	\$50,000
Total Assets	\$950,000

Liabilities

AP Wholesale	\$125,000
AP Other	\$25,000
Accrued Liabilities	\$10,000
Note Payable	\$200,000
Total Liabilities	\$360,000

Equity

Retained Earnings	\$257,500
Net Income	\$332,500
Total Liabilities & Equity	\$950,000

ABC Pharmacy, Inc.
Profit & Loss
January – December 31, 2018

Revenues	\$4,750,000
<u>Cost of Goods Sold</u>	<u>\$3,562,500</u>
Gross Profit	\$1,187,500
Salary Bob	\$120,000
Salary Betty	\$120,000
Salaries Other	\$235,000
Other Expenses	\$380,000
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Total Expenses	\$855,000
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Net Income	\$332,500

ABC Pharmacy, Inc.
Balance Sheet - Cash Basis
12.31.18

Assets

Cash	\$350,000
AR Third Party	\$0
Inventory	\$250,000
Net Fixed Assets	\$50,000
Total Assets	\$650,000

Liabilities

AP Wholesale	\$125,000
AP Other	\$0
Accrued Liabilities	\$0
Note Payable	\$200,000
Total Liabilities	\$325,000

Equity

Retained Earnings	\$257,500
Net Income	\$67,500
Total Liabilities & Equity	\$325,000

ABC Pharmacy, Inc.
Profit & Loss
January – December 31, 2018

Revenues	\$4,750,000
<u>Cost of Goods Sold</u>	<u>\$3,562,500</u>
Gross Profit	\$1,187,500
Salary Bob	\$120,000
Salary Betty	\$120,000
Salaries Other	\$235,000
Accrual to Cash 481(a) Adj. Expense	\$265,000
<u>Other Expenses</u>	<u>\$380,000</u>
Total Expenses	\$1,120,000
Net Income	<u>\$67,500</u>

Example 1:

Bob and Betty do not plan for taxes.

**2018 1040 Tax Return
Bob & Betty
Joint Filing**

Wages	\$240,000
ABC Pharmacy, Inc. Income	\$332,500
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Adjusted Gross Income	\$572,500
Standard Deduction	\$24,000
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Taxable Income	\$548,500
Federal Tax	\$143,354

*Assume pharmacy is a SSTB under Section 199A in this example.

Example 2:

Bob and Betty adjust from accrual to cash accounting and file Form 3115. The 481(a) adjustment from accrual to cash is a negative \$265,000. This figure is derived from the December 31, 2017 balance sheet which would include reversing out third party accounts receivable and other liabilities.

**2018 1040 Tax Return
Bob & Betty
Joint Filing**

Wages	\$240,000
ABC Pharmacy, Inc. Income	\$67,500
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Adjusted Gross Income	\$307,500
Standard Deduction	\$24,000
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Taxable Income	\$283,500
Section 199A Deduction ($\$67,500 * 20\%$)	\$13,500
Adjusted Taxable Income	\$270,000
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Federal Tax	\$53,379

Example 3:

Same facts as in example two however, Bob and Betty are looking for other strategies to mitigate their tax. During tax planning, Bob and Betty decided to implement a cash balance retirement plan. The expanded retirement plan has allowed Bob and Betty to put away another \$125,000 of retirement funds paid by ABC Pharmacy, Inc. and shown as an expense on the books.

**2018 1040 Tax Return
Bob & Betty
Joint Filing**

Wages	\$240,000
ABC Pharmacy, Inc. Income (\$67,500 - \$125,000)	-\$57,500
Adjusted Gross Income	\$182,500
Itemized Deduction	\$24,000
Taxable Income	\$158,500
Federal Tax	\$26,749