DEPARTMENT OF TAXATION

STATE OF HAWAII

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RE: Corporation Tax Rates For 1987

Act 237 (S.B. No. 320, S.D. 2, H.D. 1, C.D. 1), signed into law by the Governor on June 24, 1987, amends the income tax rates imposed on corporations, regulated investment companies, and real estate investment trusts.

I. CORPORATE TAX RATES.

Effective January 1, 1987, the tax imposed on corporations under Hawaii Revised Statutes section 235-71(a) shall be computed at the following rates:

A. Taxable Income Other Than Income From Capital Gain Subject To The Special Capital Gain Rate ("regular corporate rate").

4.4 per cent of taxable income not over $25, 000;

5.4 per cent of taxable income over $25,000, but not over $100,000; and

6.4 per cent of taxable income over $100,000.

B. Capital Gain Entitled To The Alternate Tax Treatment Under The Internal Revenue Code (i.e., net capital gain as defined under section 1222 of the Internal Revenue Code) ("special capital gain rate").

3.08 per cent of the amount of net capital gain which is properly taken into account before April 1, 1987; and

4 per cent of the excess net capital gain for the taxable year.

II. TAXABLE YEAR STRADDLING TAX RATE CHANGE.

With respect to the regular corporate rate, a special computation is required if the rate change is effective on a day other than the first day of the taxpayer's taxable year. The special computation reflects the fact that different tax rates apply to the taxpayer's income for that taxable year.

The special computation is made by computing tentative taxes for the entire year under the different rates, and then adding together proportionate parts of each tentative tax based on the number of days in the year that each of the rates is in effect. The computation is as follows:

1. Compute a tentative tax by applying the old rate to the taxable income for the entire year.

2. Compute a second tentative tax by applying the new rate to the taxable income for the entire year.

3. Determine the percentage that the number of days during which the old rate was in effect in the taxable year is to the total days in the year and take that proportion of the old rate tentative tax.

4. Determine the percentage that the number of days during which the new rate was in effect in the taxable year is to the total days in the year and take that proportion of the new rate tentative tax.

5. The tax for the year is the sum of the proportions of the old rate tentative tax and the new rate tentative tax.

Example: <u>Facts.</u> A fiscal year corporation has taxable income of $20,000. The taxable year beginning June 1, 1986, and ending May 31, 1987, contains 365 days. During the taxable year, the tax rates are changed, effective January 1, 1987.

<u>Analysis.</u> The corporation's tax for the year is $1,050, computed as follows:

1.	Tax for the entire year computed at the old rate:	$20,000 X 5.85%	$1,170
2.	Tax for the entire year computed at the new rate:	$20,000 X 4.4%	$ 880
3.	Portion of tax in step 1 for the period before January 1, 1987:	$1,170 X 214/365	$ 686
4.	Portion of tax in step 2 for the period after December 31, 1986:	$880 x 151/365	$ 364
5.	Total tax for the year -- steps 3 and 4:	$686 + $364	$1,050

III. APPLICATION OF THE REGULAR CORPORATE RATE AND SPECIAL CAPITAL GAIN RATE FOR TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1986.

Effective January 1, 1987, the following analyses outline the steps to determine a corporation's tax for the entire year when it either (1) does not have a net capital gain, or (2) has a net capital gain.

A. Tax Computation If A Corporation With A Taxable Year Beginning After December 31, 1986, Does Not Have A Net Capital Gain.

1. Determine the taxable income of the corporation.

2. The entire taxable income shall be subject to the regul corporate rate.

Example (1): Facts. A calendar year corporation has taxable income of 10,000 (includes $5,000 of short term capital gain) for the 1987 taxable year. The corporation does not have a net capital gain.

Analysis. All taxable income (includes the short term capital gain) shall be subject to the regular corporate tax rate. The tax for the year shall be computed as follows:

4.4% x $10,000 = $440.

B. Tax Computation If A Corporation With A Taxable Year Beginning After December 31, 1986, Has A Net Capital Gain.

1. Determine the taxable income of the corporation.

2. Less: net capital gain.

3. Taxable income exclusive of net capital gain (Rationale: to determine separately the tax on each portion).

4. Compute the tax on taxable income (exclusive of net capital gain) by applying the regular corporate rate (i.e., step 3 multiplied by the regular corporate rate).

5. Compute the tax on net capital gain.

   (a) Determine the net capital gain for the pre-April 1, 1987, period (include only gain or loss which is properly taken into account for the portion of the taxable year before April 1, 1987). The formula to determine net capital gain is as follows:

      (i) Net long term capital gain equals long term capital gain less long term capital loss

      (ii) Net short term capital loss equals short term capital loss less short term capital gain

      (iii) Net capital gain equals net long term capital gain less net short term capital loss

(b) Determine the sum of -

(i) 3.08 per cent of the lesser of -

(A) The net capital gain determined by including only gain or loss which is properly taken into account for the portion of the taxable year before April 1, 1987 (i.e., the amount in (a)), or

(B) The net capital gain for the taxable year, and

(ii) 4 per cent of the excess (if any) of -

(A) The net capital gain for the taxable year, over

(B) The amount of the net capital gain taken into account under (i).

(iii) The tax on the net capital gain for the year is the sum of (i) and (ii).

6. The tax for the year is the sum of the regular corporate tax (i.e., step 4) and the special capital gain tax (i.e., step 5).

Example (2): Facts. For taxable year 1987, a calendar year corporation has taxable income of $150,000. The taxable income includes a net capital gain of $9,500, resulting from the following capital transactions:

Date Capital Gain/(Loss) Is Properly Taken Into Account	Character of Capital Gain/(Loss)	Amount of Capital Gain/(Loss)
01/02/87	short term capital loss	$(1,000)
02/15/87	long term capital gain	$ 7,000
03/10/87	long term capital loss	$(1,500)
04/15/87	short term capital gain	$ 500
07/05/87	long term capital loss	$(500)
08/15/87	long term capital gain	$ 5,000

The net capital gain of $9,500 is computed as follows:

short term capital loss	$(1,000)	
short term capital gain	500	
net short term capital loss		$(500)
long term capital gain	7,000	
long term capital gain	5,000	
long term capital loss	(1,500)	
long term capital loss	(500)	
net long term capital gain		10,000

net capital gain: (net long term capital gain less net short term capital loss) $ 9,500

Analysis. Since the corporation has a net capital gain, the tax for the year is $8,081, computed as follows:

1.	Taxable income	$150,000
2.	Less: net capital gain	$ 9,500
3.	Taxable income exclusive of net capital gain	$140,500

4. Tax on $140,500 of taxable income (exclusive of net capital gain):

(a)	4.4% of the first $25,000	$1,100
(b)	5.4% of the next $75,000	$4,050
(c)	6.4% of the excess	$2,592
	Tax on taxable income other than net capital gain -- sum of (a), (b), and (c): $1,100 + $4,050 + $2,592	$7,742

5. Tax on $9,500 of net capital gain:

(a) Determine the net capital gain for the pre-April 1, 1987, period (include only gain or loss which is properly taken into account for the portion of the taxable year before April 1, 1987).

(i) [Net long term capital gain] $5,500 = [long term capital gain] $7,000 - [long term capital loss] $1,500

(ii) [Net short term capital loss] $1,000 = [short term capital loss] $1,000 - [short term capital gain] $0

(iii) [Net capital gain] $4,500 = [net long term capital gain] $5,500 - [net short term capital loss) $1,000

(b) Determine the sum of -

(i) $139 (lesser of (1) 3.08% of the $4,500 pre-April 1, 1987, net capital gain, or (2) 3.08% of the $9,500 net capital gain for the entire year) plus

(ii) $200 (4% of the $5,000 excess net capital gain for the entire year).

(iii) The tax on the net capital gain for the year is $339.

6. Total tax for the year -- sum of steps 4 and 5: $7,742 + $339 — $8,081

Example (3): Facts. For taxable year 1987, a calendar year corporation has taxable income of $200,000. The taxable income includes a net capital gain of $3,000, resulting from the following capital transactions:

Date Capital Gain/(Loss) Is Properly Taken Into Account	Character of Capital Gain/(Loss)	Amount of Capital Gain/(Loss)
02/15/87	long term capital loss	$(500)
03/10/87	long term capital gain	$ 5,000
06/15/87	long term captial loss	$(1,500)

The net capital gain of $3,000 is computed as follows:

short term capital loss	$(0)	
short term capital gain	0	
net short term capital loss		$(0)
long term capital gain	5,000	
long term capital loss	(500)	
long term capital loss	(1,500)	
net long term capital gain		3,000
net capital gain: (net long term capital gain less less net short term capital loss)		$3,000

Analysis. Since the corporation has a net capital gain, the tax for the year is $11,450, computed as follows:

1. Taxable income $200,000

2. Less: net capital gain 3,000

3. Taxable income exclusive of net capital gain $197,000

4. Tax on $197,000 of taxable income (exclusive of net capital gain):

   (a) 4.4% of the first $25,000 . . . . . . $1,100
   (b) 5.4% of the next $75,000 . . . . . . $4,050
   (c) 6.4% of the excess $6,208
   (d) Tax on taxable income other than net capital gain -- sum of (a), (b), and (c): $1,100 + $4,050 + $6,208 . . . . . . $11,358

5. Tax on $3,000 of net capital gain:

(a) Determine the net capital gain for the pre-April 1, 1987, period (include only gain or loss which is properly taken into account for the portion of the taxable year before April 1, 1987).

(i) [Net long term capital gain] $4,500 = [long term capital gain] $5,000 - [long term capital loss] $500

(ii) [Net short term capital loss] $0 = [short term capital loss] $0 - [short term capital gain] $0

(iii) [Net capital gain] $4,500 = [net long term capital gain] $4,500 - [net short term capital loss] $0

(b) Determine the sum of -

(i) $92 (lesser of (1) 3.08% of the $4,500 pre-April 1, 1987, net capital gain, or (2) 3.08% of the $3,000 net capital gain for the entire year) plus

(ii) $0 (4% of the $0 excess net capital gain for the entire year).

(iii) The tax on the net capital gain for the year is $92.

6. Total tax for the year -- sum of steps 4 and 5: $11,358 + $92 — $11,450

C. <u>Tax Computation If A Corporation Has Net Short Term Capital Gain Instead Of Net Short Term Capital Loss, But Overall Has A Net Capital Gain For The Taxable Year.</u>

<u>Example (4):</u> <u>Facts.</u> For taxable year 1987, a calendar year corporation has taxable income of $200,000. The taxable income includes a net capital gain of $10,000, resulting from the following capital transactions:

Date Capital Gain/(Loss) Is Properly Taken Into Account	Character of Capital Gain/(Loss)	Amount of Capital Gain/(Loss)
01/02/87	short term capital gain	$ 500
02/15/87	long term capital gain	$ 7,000
03/10/87	long term capital loss	$(1,500)
05/05/87	long term capital loss	$(500)
06/15/87	long term capital gain	$ 5,000

The net capital gain for the year of $10,000 is computed as follows:

short term capital gain	$ 500	
short term capital loss	(0)	
net short term capital gain		$ 500
long term capital gain	7,000	
long term capital gain	5,000	
long term capital loss	(1,500)	
long term capital loss	(500)	
net long term capital gain		$10,000
net capital gain: (net long term capital gain less net short term capital loss)		$10,000

Analysis. Since the corporation has a net capital gain, the tax tax for the year is $11,259, computed as follows:

1. Taxable income $200,000

2. Less: net capital gain . . . . $ 10,000

3. Taxable income exclusive of net capital gain $190,000

4. Tax on $190,000 of taxable income (exclusive of net capital gain):

   (a) 4.4% of the first $25,000 . . . . $ 1,100
   (b) 5.4% of the next $75,000 . . . . $ 4,050
   (c) 6.4% of the excess . . . . $ 5,760
   (d) Tax on taxable income other than net capital gain -- sum of (a), (b), and (c): $1,100 + $4,050 + $5,760 . . . .$10,910

5. Tax on $10,000 of net capital gain:

   (a) Determined the net capital gain for the pre-April 1, 1987, period (include only gain or loss which is properly taken into account for the portion of the taxable year before April 1, 1987).

      (i) [Net long term capital gain] $5,500 = [long term capital gain] $7,000 - [long term capital loss] $1,500

      (ii) [Net short term capital gain] $500 = [short term capital gain] $500 - [short term capital loss] $0

      (iii) [Net capital gain] $5,500 = [net long term capital gain] %5,500 - [net short term capital loss] $0

(b) Determine the sum of -

(i) $169 (lesser of (1) 3.08% of the $5,500 pre-April 1, 1987, net capital gain, or (2) 3.08% of the $10,000 net capital gain for the entire year) plus

(ii) $180 (4% of the $4,500 excess net capital gain for the entire year).

(iii) The tax on the net capital gain for the entire year is $349.

6. Total tax for the year -- sum of steps 4 and 5: $10,910 + $349 $ 11,259

D. <u>Tax Computation If Taxable Income (i.e., ordinary income plus net capital gain minus deductions) Is Less Than Net Capital Gain. Two Calculations Should Be Completed To Determine Which Results In The Least Tax Payable As Follows</u>:

1. Regular computation: Compute the tax on taxable income by applying the regular corporate rate.

2. Alternative computation: The sum of -

(a) The tax on taxable income exclusive of net capital gain (apply the regular corporate rate), plus

(b) The tax on net capital gain (apply the special capital gain rate).

The tax payable is the lesser amount under either the regular or alternative computation.

<u>Example (5):</u> <u>Facts.</u> For taxable year 1987, a calendar year corporation has $10,000 of ordinary income, $100,000 of net capital gain, and $70,000 of allowable deductions. A $100,000 net capital gain results from a long term capital gain transaction on February 1, 1987. The taxable income is $40,000 (i.e., [ordinary income] $10,000 plus [net capital gain] $100,000 minus [allowable deductions] $70,000).

<u>Analysis:</u> The tax for 1987 is computed as follows:

1. Regular computation: (tax computed on taxable income of $40,000)

(a) 4.4% of the first $25,000 . . . . $1,100
(b) 5.4% of the excess . . . . $ 810
(c) Tax based on the regular computation -- sum of (a) and (b) $1,100 + $810 . . . . $1,910

2. Alternative computation: The sum of -

(a) Tax on taxable income exclusive of net capital gain ($40,000 minus $100,000) .... $ 0
(b) Tax on net capital gain (3.08% multiplied by $100,000) . . . $3,080
(c) Tax based on the alternative computation -- sum of (a) and (b): $0 + $3,080 .... $3,080

In this case, the tax computed under the regular method, being less than the alternative tax, is the amount payable.

Example (6): Facts. For taxable year 1987, a calendar year corporation has $20,000 of ordinary income, $100,000 of net capital gain, and $50,000 of allowable deductions. A $100,000 net capital gain results from a long term capital gain transaction on March 10, 1987. The taxable income is $70,000 (i.e., [ordinary income] $20,000 plus [net capital gain] $100,000 minus [allowable deductions] $50,000).

Analysis. The tax for 1987 is computed as follows:

1. Regular computation: (tax computed on taxable income of $70,000)

(a) 4.4% of the first $25,000 .... $1,100
(b) 5.4% of the excess $2,430
(c) Tax based on the regular computation -- sum of (a) and (b): $1,100 + $2,430 . . . . . $3,530

2. Alternative computation:

(a) Tax on taxable income exclusive of net capital gain ($70,000 minus 100,000) .... $ 0
(b) Tax on net capital gain (3.08% multiplied by $100,000) ... $3,080
(c) Tax based on the alternative computation -- sum of (a) and (b): $0 + $3,080 .... $3,080

In this case, the tax computed under the alternative method, being less than the regular tax, is the amount payable.

IV. APPLICATION OF THE REGULAR CORPORATE RATE AND SPECIAL CAPITAL GAIN RATE FOR TAXABLE YEARS BEGINNING BEFORE JANUARY 1, 1987, AND ENDING AFTER DECEMBER 31, 1986.

Effective January 1, 1987, for taxable years beginning before January 1, 1987, and ending after December 31, 1986, the following analyses outline the steps to determine a corporation's tax for the entire year when it either (1) does not have a net capital gain, or (2) has a net capital gain.

A. Tax Computation If A Corporation With a Taxable Year Beginning Before January 1, 1987, And Ending After December 31, 1986 Does Not Have A Capital Gain.

1. Determine the taxable income of the corporation.

2. Compute the tax on the taxable income by computing the tentative regular corporate rate tax for the entire year under the old and new rates, and then adding together proportionate parts of each tentative tax based on the number of days in the year that each of the rates is in effect.

B. Tax Computation If A Corporation With A Taxable Year Beginning Before January 1, 1987, And Ending After December 31, 1986, Has A Net Capital Gain.

1. Determine the taxable income of the corporation.

2. Less:net capital gain.

3. Taxable income exclusive of net capital gain.

4. Compute the tax on taxable income (exclusive of net capital gain) by computing the tentative regular corporate rate tax for the entire year under the old and new rates, and then adding together proportionate parts of each tentative tax based on the number of days in the year that each of the rates is in effect.

5. Compute the tax on net capital gain.

(a) Determine the net capital gain by taking into account only gain or loss which is properly taken into account for the portion of the taxable year before April 1, 1987.

(i) Net long term capital gain equals long term capital gain less long term capital loss

(ii) Net short term capital loss equals short term capital loss less short term capital gain

(iii) Net capital gain equals net long term capital gain less net short term capital loss

(b) Determine the sum of -

(i) 3.08 per cent of the lesser of -

(A) The net capital gain determined by including only gain or loss which is properly taken into account for the portion of the taxable year before April 1, 1987 (i.e., the amount in (a)), or

(B) The net capital gain for the taxable year, and

(ii) 4 per cent of the excess (if any) of -

(A) The net capital gain for the taxable year, over

(B) The amount of the net capital gain taken into account under (i).

(iii) The tax on the net capital gain for the year is the sum of (i) and (ii).

6. The tax for the year is the sum of the regular corporate tax (i.e., step 4) and the special capital gain tax (i.e., step 5).

<u>Example (1):</u> <u>Facts.</u> A fiscal year corporation has taxable income of $50,000 (includes a net capital gain of $6,000). The taxable year, beginning September 1, 1986, and ending August 31, 1987, contains 365 days. The net capital gain of $6,000, resulting from a $2,000 long term capital gain transaction on December 7, 1986, and a $4,000 long term capital gain transaction on August 1, 1987, is computed as follows:

short term capital loss	$(0)	
short term capital gain	0	
net short term capital loss		$(0)
long term capital-gain	2,000	
long term capital gain	4,000	
long term capital loss	(0)	
net long term capital gain		6,000
net capital gain: (net long term capital gain less net short term capital loss)		$6,000

<u>Analysis:</u> Since the corporation has a net capital gain, the tax for the year is $2,535, computed as follows:

1. Taxable income $50,000

2. Less: net capital gain $6,000

3. Taxable income exclusive of net capital gain $44,000

4. Compute the tax on $44,000 of taxable income (exclusive of net capital gain):

   (a) Tax for the entire year computed at the old rate:

      (i) 5.85% of the first $25,000 . . . . $1,463
      (ii) 6.435% of the excess $1,223

(iii) Sum of (i) and (ii):
$1,463 + $1,223 . . . . $2,686

(b) Tax for the entire year computed at the new rate:

(i) 4.4% of the first $25,000 . . . . $1,100
(ii) 5.4% of the excess $1,026
(iii) Sum of (i) and (ii):
$1,100 + $1,026 . . . . $2,126

(c) Portion of tax in (a) for the period before January 1, 1987:
$2,686 X 122/365 $ 898

(d) Portion of tax in (b) for the period after December 31, 1986:
$2,126 X 243/365 $1,415

(e) Tax for the year on taxable income other than net capital gain -- sum of (c) and (d):
$898 + $1,415 $2,313

5. Tax on $6,000 of net capital gain:

(a) Determine the net capital gain for the pre-April 1, 1987, period (include only gain or loss which is properly taken into account for the portion of the taxable year before April 1, 1987).

(i) [Net long term capital gain] $2,000 = [long term capital gain] $2,000 - [long term capital loss] $0

(ii) [Net short term capital loss] $0 = [short term capital loss] $0 - [short term capital gain] $0

(iii) [Net capital gain] $2,000 = [net long term capital gain] $2,000 - [net short term capital loss] $0

(b) Determine the sum of -

(i) $62 (lesser of (1) 3.08% of the $2,000 pre-April 1, 1987, net capital gain, or (2) 3.08% of the $6,000 net capital gain for the entire year) plus

(ii) $160 (4% of the $4,000 excess net capital gain for the entire year).

(iii) The tax on the net capital gain for the entire year is $222.

6. Total tax for the year -- sum of steps 4 and 5: $2,313 + $222 $2,535

C. <u>Tax Computation If Taxable Income (i.e., ordinary income plus net capital gain minus deductions) Is Less Than Net Capital Gain. Two Calculations Should Be Completed To Determine Which Results In The Least Tax Payable As Follows:</u>

1. Regular computation: Compute the tax on taxable income by applying the regular corporate rate.

2. Alternative computation: The sum of

   (a) The tax on taxable income exclusive of net capital gain (apply the regular corporate rate), plus

   (b) The tax on net capital gain (apply the special capital gain rate).

The tax payable is the lesser amount under either the regular or alternative computation.

<u>Example (2):</u> <u>Facts.</u> A fiscal year corporation has $5,000 of ordinary income, $95,000 of net capital gain, and $60,000 of allowable deductions. The taxable year, beginning June 1, 1986, and ending May 31, 1987, contains 365 days. The $95,000 of net capital gain is a result of the following capital transactions:

Date Capital Gain/(Loss) Is Properly Taken Into Account	Character of Capital Gain/(Loss)	Amount of Capital Gain/(Loss)
09/01/86	short term capital loss	$(1,000)
12/21/86	long term capital loss	$(1,500)
03/10/87	long term capital gain	$ 92,500
04/15/87	short term capital gain	500
05/01/87	long term capital loss	$(500)
05/15/87	long term capital gain	$ 5,000

The net capital gain of $95,000 is computed as follows:

short term capital loss	$(1,000)	
short term capital gain	500	
net short term capital loss		$(500)
long term capital gain	92,500	
long term capital gain	5,000	
long term capital loss	(1,500)	
long term capital loss	(500)	
net long term capital gain		95,500
net capital gain: (net long term capital gain less net short term capital loss)		$95,000

The taxable income is $40,000 (i.e., [ordinary income] $5,000 plus [net capital gain] $95,000 minus [allowable deductions] $60,000.

Analysis. The tax payable for the year is $2,214, computes as follows:

1. Regular computation: (tax computed on taxable income of $40,000)

   (a) Tax for the entire year computed at the old rate:

(i)	5.85% of the first $25,000	$1,463
(ii)	6.435% of the excess	$ 965
(iii)	Sum of (i) and (ii): $1,463 + $965	$2,428

   (b) Tax for the entire year computed at the new rate:

(i)	4.4% of the first $25,000	$1,100
(ii)	5.4% of the excess	$ 810
(iii)	Sum of (i) and (ii): $1,100 + $810	$1,910

   (c) Portion of the tax in (a) for the period before January 1, 1987:
   $2,428 x 214/365 — $1,424

   (d) Portion of the tax in (b) for the period after December 31, 1986:
   $1,910 x 151/365 — $ 790

   (e) Tax based on the regular computation -- sum of (c) and (d): $1,424 + $790 — $2,214

2. Alternative computation: The sum of -

   (a) Tax on taxable income exclusive of net capital gain ($40,000 minus $95,000) — $0

   (b) Tax on $95,000 of net capital gain:

      (i) Determine the net capital gain for the pre-April 1, 1987, period (include only gain or loss which is properly taken into account for the portion of the taxable year before April 1, 1987).

         (A) [Net long term capital gain] $91,000 = [long term capital gain] $92,500 - [long term capital loss] $1,500

         (B) [Net short term capital loss] $1,000 = [short term capital loss] $1,000 - short term capital gain] $0

         (C) [Net capital gain] $90,000 = [net long term capital gain] $91,000 - [net short term capital loss] $1,000

(ii) Determine the sum of -

(A) $2,772 (lesser of (1) 3.08% of the $90,000 pre-April 1, 1987, net capital gain, or (2) 3.08% of the $95,000 net capital gain for the entire year) plus

(b) $200 (4% of the $5,000 excess net capital gain for the entire year).

(C) The tax on the net capital gain for the year is $2,972.

(c) Tax based on the alternative computation -- sum of (a) and (b): $0 + $2,972 — $2,972

In this case, the tax computed under the regular method, being less than the alternative tax, is the amount payable.

<u>Example (3):</u> <u>Facts.</u> A fiscal year corporation has $5,000 of ordinary income, $95,000 net capital gain, and $20,000 of allowable deductions. The taxable year, beginning June 1, 1986, and ending May 31, 1987, contains 365 days. The net capital gain of $95,000 is a result of the same capital transactions as stated in Example (2). The net capital gain of $95,000 is computed as illustrated in Example (2). The taxable income is $80,000 (i.e., [ordinary income] $5,000 plus [net capital gain] $95,000 minus [allowable deductions] $20,000).

<u>Analysis.</u> The tax payable for the year is $2,972, computed as follows:

1. Regular computation: (tax computed on taxable income of $80,000)

(a) Tax for the entire year computed at the old rate:

(i)	5.85% of the first $25,000	$1,463
(ii)	6.435% of the excess	$3,539
(iii)	Sum of (i) and (ii): $1,463 + 3,539	$5,002

(b) Tax for the entire year computed at the new rate:

(i)	4.4% of the first $25,000	$1,100
(ii)	5.4% of the excess	$2,970
(iii)	Sum of (i) and (ii): $1,100 + $2,970	$4,070

(c) Portion of the tax in (a) for the period before January 1, 1987:
$5.002 x 214/365 — $2,933

(d) Portion of the tax in (b) for the period after December 31, 1986:
$4.070 x 151/365 — $1,684

(e) Tax based on the regular computation -- sum of (c) and (d): $2,933 + $1,684 — $4,617

2. Alternative computation: The sum of -

(a) Tax on taxable income exclusive of net capital gain ($80,000 minus $95,000) — $0

(b) Tax on net capital gain of $95,000:

(i) Determine the net capital gain for the pre-April 1, 1987, period (include only gain or loss which is properly taken into account for the portion of the taxable year before April 1, 1987).

(A) [Net long term capital gain] $91,000 = [long term capital gain] $92,500 - [long term capital loss] $1,500

(B) [Net short term capital loss] $1,000 = [short term capital loss] $1,000 - [short term capital gain] $0

(C) [Net capital gain] $90,000 = [net long term capital gain] $91,000 - [net short term capital loss] $1,000

(ii) Determine the sum of -

(A) $2,772 (lesser of (1) 3.08% of the $90,000 pre-April 1, 1987, net capital gain, or (2) 3.08% of the $95,000 net capital gain for the entire year) plus

(B) $200 (4% of the $5,000 excess net capital gain for the entire year).

(C) The tax on the net capital gain for the year is $2,972.

(c) Tax based on the alternative computation -- sum of (a) and (b): $0 + $2,972 — $2,972

In this case, the tax computed under the alternative method, being less than the regular tax, is the amount payable.

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