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CPA

Certified Public Accountant (Regulation)

Version 1.0

Exam A

QUESTION 1

Parker, whose spouse died during the preceding year, has not remarried. Parker maintains a home for a dependent child. What is Parker's most advantageous filing status?

A. Single.
B. Head of household.
C. Married filing separately.
D. Qualifying widow(er) with dependent child.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. A qualifying widow (er) is a taxpayer who may use the joint tax return standard deduction and rates (but not the exemption for the deceased spouse) for each of two taxable years following the year of death of his or her spouse, unless he or she remarries. The surviving spouse must maintain a household that, for the whole entire taxable year, was the principal place of abode of a son, stepson, daughter, or stepdaughter (whether by blood or adoption). The surviving spouse must also be entitled to a dependency exemption for such individual. Parker may file as a qualifying widow (er) since her spouse died in the previous tax year, she did not remarry and she maintained a home for a dependent child. Since, qualifying widow (er) is the most advantageous status and Parker qualifies, Parker would file as a qualifying widow (er).
Choice "a" is incorrect. Even though Parker would qualify as single, filing single would give Parker a high tax liability than the qualifying widow (er) status and therefore is not most advantageous.
Choice "b" is incorrect. Parker would not qualify as head of household for the first two years after the death of Parker's spouse because one of the requirements for Head of Household status is that the taxpayer is NOT a surviving spouse. (Also, note that the likely reason for this requirement is that filing as Head of Household status would give the qualifying surviving spouse taxpayer a higher tax liability than the Qualifying Widow(er) status, which would be less advantageous.)
Choice "c" is incorrect. Parker would not qualify to file married filing separately.

QUESTION 2 In which of the following situations may taxpayers file as married filing jointly?

A. Taxpayers who were married but lived apart during the year.
B. Taxpayers who were married but lived under a legal separation agreement at the end of the year.
C. Taxpayers who were divorced during the year.
D. Taxpayers who were legally separated but lived together for the entire year.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

RULE: In order to file a joint return, the parties must be MARRIED at the end of the year. Exception: If the parties are married but are LEGALLY SEPARATED under the laws of the state in which they reside, they cannot file a joint return (they will file either under the single or head of household filing status).

Choice "a" is correct. Per the above rule, taxpayers who are married but lived apart during the year are allowed to file a joint return for the year. The fact that they did not live together during the year has no bearing on the issue.
Choice "b" is incorrect. Per the above rule, taxpayers who are married but lived under a legal separation agreement at the end of the year may not file a joint return. They will generally file either under the single or head of household filing status.
Choice "c" is incorrect. Per the above rule, taxpayers who were divorced during the year may not file a joint return together, as they are not married at the end of the year. [Note, however, that they may become married again in the year and file a joint return with the new spouse.]
Choice "d" is incorrect. Per the above rule, taxpayers who were legally separated but lived together for the entire year may not file a joint return. They will generally file either under the single or head of household filing status.

QUESTION 3
Barkley owns a vacation cabin that was rented to unrelated parties for 10 days during the year for $2,500. The cabin was used personally by Barkley for three months and left vacant for the rest of the year. Expenses for the cabin were as follows:

Real estate taxes $1,000
Maintenance and utilities $2,000

How much rental income (loss) is included in Barkley's adjusted gross income?

A. $0
B. $500
C. $(500)
D. $(1,500)

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

RULE: If a vacation residence is rented for less than 15 days per year, it is treated as a personal residence. The rental income is excluded from income, and mortgage interest (first or second home) and real estate taxes are allowed as itemized deductions. Depreciation, utilities, and repairs are not deductible.

Choice "a" is correct. Applying the rule above, if a vacation residence is rented for less than 15 days per year, it is treated as a personal residence. The rental income ($2,500 in this case) is excluded from income. A Schedule E is not filed for this property (i.e., no income is reported, the taxes are reported as itemized deductions, and the maintenance and utilities are not deductible), so the effect on AGI is zero.
Choice "b" is incorrect. This assumes that the property taxes are reported as itemized deductions but that the rental income ($2,500) less the maintenance and utilities ($2,000) are reported net on Schedule E.
Per the above RULE, the rental income is excluded from income, and the maintenance and utilities are not deductible.
Choice "c" is incorrect. This assumes that all of the items shown are reported net on the Schedule E-$2,500 - $1,000 - $2,000 = ($500). Per the above RULE, the rental income is excluded from income, the maintenance and utilities are not deductible, and the property taxes are reported on Schedule A as an itemized deduction. Choice "d" is incorrect, per the above rule and discussion.

QUESTION 4
In evaluating the hierarchy of authority in tax law, which of the following carries the greatest authoritative value for tax planning of transactions?

A. Internal Revenue Code.
B. IRS regulations.
C. Tax court decisions.
D. IRS agents' reports.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Note: This question is addressed in your Appendix D text materials. We are confident that our students would be able to respond correctly over 85% of the time without any guidance on this topic. The answer is rather obvious. Just by looking at the answer options, you will immediately notice that Option A is presented in title case. This would be a quick sign that it may be the correct response. Further, we suspect that most students would narrow the options down to "a" or "b" by simply using common sense.
While we are confident that our students would fare well on this question if it appeared on their exams, we present the following detailed explanation of the answer options.

Choice "a" is correct. According to the IRS's website under Tax Code, Regulations and Official Guidance, the "federal tax law begins with the Internal Revenue Code (IRC), [which was] enacted by Congress in Title 26 of the United States Code (26 U.S.C.)." The IRC holds the most authoritative value.
Choice "b" is incorrect. According to the IRS's website under Tax Code, Regulations and Official Guidance, the IRS regulations or "Treasury regulations (26 C.F.R.)-commonly referred to as Federal tax regulations-pick up where the Internal Revenue Code (IRC) leaves off by providing the official interpretation of the IRS by the U.S. Department of Treasury." Regulations give directions on how to apply the law outlined in the Internal Revenue Code. Regulations have the second most force and effect, second only to the IRC.
Choice "c" is incorrect. Tax court decisions interpret the Internal Revenue Code. They do not have the authority of the IRC.
Choice "d" is incorrect. The reports of IRS agents are used to report on specific taxpayer situations. IRS agents' reports apply the Internal Revenue Code, IRS regulations, and other forms of authoritative literature, but they do not hold the value that the IRC, the IRS regulations, or even tax court decisions have.

QUESTION 5
In 19X4, Smith, a divorced person, provided over one half the support for his widowed mother, Ruth, and his son, Clay, both of whom are U.S. citizens. During 19X4, Ruth did not live with Smith. She received $9,000 in Social Security benefits. Clay, a 25 year-old full-time graduate student, and his wife lived with Smith. Clay had no income but filed a joint return for 19X4, owing an additional $500 in taxes on his wife's income. How many exemptions was Smith entitled to claim on his 19X4 tax return?

A. 4
B. 3
C. 2

D. 1

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Smith is entitled to an exemption for himself. He is also entitled to an exemption for his mother Ruth (qualifying relative). Ruth has $9,000 in Social Security payments during 19X4, but since that is her only income, the Social Security is not taxable, and nontaxable income does not count in calculating whether an exemption can be taken for a dependent. Clay cannot be taken as a dependent because he filed a joint return with his wife. Since the joint return was filed for a purpose other than simply claiming a refund, the joint return prevents Smith from claiming an exemption for Clay. An exemption cannot be taken for Clay's wife because she filed a joint return with Clay. Smith is entitled to two exemptions.
Choice "a" is incorrect. Clay cannot be taken as a dependent because he filed a joint return with his wife. Since the joint return was filed for a purpose other than simply claiming a refund, the joint return prevents Smith from claiming an exemption for Clay. An exemption cannot be taken for Clay's wife because she filed a joint return with Clay.
Choice "b" is incorrect. Clay cannot be taken as a dependent because he filed a joint return with his wife. Since the joint return was filed for a purpose other than simply claiming a refund, the joint return prevents Smith from claiming an exemption for Clay. An exemption cannot be taken for Clay's wife because she filed a joint return with Clay.
Choice "d" is incorrect. Smith is entitled to an exemption for his mother, Ruth. Ruth has $9,000 in Social Security payments during 19X4, but because that is her only income, the Social Security income is not taxable, and nontaxable income does not count in calculating whether an exemption can be taken for a dependent.

QUESTION 6
Darr, an employee of Sorce C corporation, is not a shareholder. Which of the following would be included in a taxpayer's gross income?

A. Employer-provided medical insurance coverage under a health plan.
B. A $10,000 gift from the taxpayer's grandparents.
C. The fair market value of land that the taxpayer inherited from an uncle.
D. The dividend income on shares of stock that the taxpayer received for services rendered.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. An individual receiving common stock for services rendered must recognize the fair market value as ordinary income. Any dividends received on that stock would also result in income recognition.
Choice "a" is incorrect. Employer-provided medical insurance is a tax-free fringe benefit.
Choices "b" and "c" are incorrect. Gifts and inheritances are both tax-free to the recipient. (Remember tax is often paid by the person giving the gift or the estate at death.)

QUESTION 7
Adams owns a second residence that is used for both personal and rental purposes. During 2001,
Adams used the second residence for 50 days and rented the residence for 200 days. Which of the following statements is correct?

A. Depreciation may not be deducted on the property under any circumstances.
B. A rental loss may be deducted if rental-related expenses exceed rental income.
C. Utilities and maintenance on the property must be divided between personal and rental use.
D. All mortgage interest and taxes on the property will be deducted to determine the property's net income or loss.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Because the second property was personally used more than 14 days, any net loss from the rental of the property will be disallowed. All related expenses must be prorated between the personal use portion and the rental activity portion. Prorated depreciation is permitted for the rental activity.

QUESTION 8
Baum, an unmarried optometrist and sole proprietor of Optics, buys and maintains a supply of eyeglasses and frames to sell in the ordinary course of business. In 1999, Optics had $350,000 in gross business receipts and its year-end inventory was not subject to the uniform capitalization rules. Baum's 1999 adjusted gross income was $90,000 and Baum qualified to itemize deductions. During 1999, Baum recorded the following information: Business expenses:

Optics cost of goods sold	$35,000
Optics rent expense	$28,000
Liability insurance premium on Optics	$ 5,250
Other expenditures:	
Baum's self-employment tax	$29,750
Baum's self-employment health insurance	$ 8,750
Insurance premium on personal residence. In 1999, Baum's home was totally destroyed by fire. The furniture had an adjusted basis of $14,000 and a fair market value of $11,000. During 1999, Baum collected $3,000 in insurance reimbursement and had no casualty gains during the year.	$ 2,625
Qualified 1999 mortgage interest on a loan to acquire a personal residence	$52,500
Annual interest on a $70,000, 5-year home equity loan. The loan was secured by Baum's home, obtained January 2, 1999. The fair market value of the home exceeded the mortgage and the home equity loan by a substantial amount. The proceeds were used to purchase a car for personal use.	$ 3,500
Points prepaid on January 2, 1999 to acquire the home equity loan	$ 1,400
Real estate taxes on personal residence	$ 2,200
Estimated payments of 1999 federal income taxes	$13,500
Local property taxes on the car value, used exclusively for personal use	$ 300

What amount should Baum report as 1999 net earnings from self-employment?

A. $243,250
B. $252,000
C. $273,000
D. $281,750

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Baum should report $281,750 as 1999 net earnings from self-employment (line 12 of the Form 1040), calculated as follows:

Gross business receipts	$350,000
Cost of goods sold	(35,000)
Rent expense	(28,000)
Liability insurance premium	(5,250)
Net earnings on Schedule C	$281,750

Choices "a", "b", and "c" are incorrect. Self-employment tax and self-employment health insurance expenses are adjustments from total gross income. They are not deducted from self-employment earnings (i.e., not reported net on line 12 of the Form 1040).
Note: There are many distracters in this question, all relating to items that are either deductible as part of itemized deductions or not deductible. Be careful to read the requirement of the question before spending unnecessary time on the question. The statement that Baum's year-end inventory was not subject to the uniform capitalization rules is a distracter as well. There is not enough information given in the facts to apply the rules if he had been subject to them.

QUESTION 9
On December 1, 1997, Krest, a self-employed cash basis taxpayer, borrowed $200,000 to use in her business. The loan was to be repaid on November 30, 1998. Krest paid the entire interest amount of $24,000 on December 1, 1997. What amount of interest was deductible on Krest's 1997 income tax return?

A. $0
B. $2,000
C. $22,000
D. $24,000

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Cash basis taxpayers deduct interest in the year paid or the year to which the interest relates, whichever is later. Even though all of the interest on this loan was paid on December 1, 1997, only the interest relating to December 1997 can be deducted in 1997. The question does not give an interest rate, but because the loan is to be repaid in a lump sum at maturity, 1/12 of the interest, or $2,000 applies to each month.
Choice "a" is incorrect. Because $2,000 of the interest relates to 1997, this amount is deductible in 1997.
Choice "c" is incorrect. This is the amount that cannot be deducted until 1998, the year to which the interest relates. Be sure to read questions like this very carefully, because if you had simply misread the question as seeking the amount deductible in 1998, you would get the question wrong despite understanding the rule.
Choice "d" is incorrect. Cash basis taxpayers can deduct interest in the year paid or the year to which the interest relates, whichever is later, thus 11 months of the interest will not be deductible until 1998.

QUESTION 10 Which payment(s) is(are) included in a recipient's
gross income?

I. Payment to a graduate assistant for a part-time teaching assignment at a university. Teaching is not a requirement toward obtaining the degree.
II. A grant to a Ph.D. candidate for his participation in a university-sponsored research project for the benefit of the university.

A. I only.
B. II only.
C. Both I and II.
D. Neither I nor II.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct.

I. A payment to a student for a part-time teaching assignment is taxable income just as a payment for any other campus job would be. This is not a scholarship or fellowship. II.
There is no exclusion in the tax law for amounts paid to a degree candidate for participation in university-sponsored research.

QUESTION 11
Under the uniform capitalization rules applicable to property acquired for resale, which of the following costs should be capitalized with respect to inventory if no exceptions are met?

	Marketing costs	Off-site storage costs
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

A. Option A B.
Option B

C. Option C D.
Option D

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Under the uniform capitalization rules, purchasers of inventory for resale may deduct their marketing costs but must capitalize their off-site storage costs. Choices "a", "b", and "c" are incorrect. Marketing costs are deductible, but off-site storage must be capitalized.

QUESTION 12
In a tax year where the taxpayer pays qualified education expenses, interest income on the redemption of qualified U.S. Series EE Bonds may be excluded from gross income. The exclusion is subject to a modified gross income limitation and a limit of aggregate bond proceeds in excess of qualified higher education expenses. Which of the following is (are) true?

I. The exclusion applies for education expenses incurred by the taxpayer, the taxpayer's spouse, or any person whom the taxpayer may claim as a dependent for the year.
II. "Otherwise qualified higher education expenses" must be reduced by qualified scholarships not includible in gross income.

A. I only.
B. II only.
C. Both I and II.
D. Neither I nor II.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Explanation
Choice "c" is correct. Interest earned on Series EE bonds issued after 1989 may qualify for exclusion. One requirement is that the interest is used to pay tuition and fees for the taxpayer, spouse, or dependent enrolled in higher education. The interest exclusion is reduced by qualified scholarships that are exempt from tax and other nontaxable payments received for educational expenses (other than gifts and inheritances).

QUESTION 13 During 1993 Kay received interest income as follows:

On U.S. Treasury certificates $4,000
On refund of 1991 federal income tax 500

The total amount of interest subject to tax in Kay's 1993 tax return is:

A. $4,500
B. $4,000
C. $500
D. $0

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Interest income from U.S. obligations is generally taxable. Interest income on a federal tax refund is taxable, even though the refund itself is not taxed. Choice "b" is incorrect. Interest income on a federal tax refund is taxable, even though the refund itself is not taxed. Choice "c" is incorrect. Interest income from U.S. obligations is generally taxable.

Choice "d" is incorrect. Interest income from U.S. obligations is generally taxable. Interest income on a federal tax refund is taxable, even though the refund itself is not taxed.

QUESTION 14

Rich is a cash basis self-employed air-conditioning repairman with 1993 gross business receipts of $20,000. Rich's cash disbursements were as follows:

Yellow Pages listing	2,000
Estimated federal income taxes on self-employment income	1,000
Business long-distance telephone calls	400
Charitable contributions	200

What amount should Rich report as net self-employment income?

A. $15,100
B. $14,900
C. $14,100
D. $13,900

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Deductions to arrive at net self-employed income include all necessary and ordinary expenses connected with the business. Estimated federal income tax payments are not an expense. Charitable contributions by an individual are only deductible as an itemized deduction on Schedule A. This assumes the contribution was not made with the "expectation of commensurate financial return."

Receipts	$20,000
Parts	(2,500)
Listing	(2,000)
Telephone	(400)
Net self-employment income	$15,100

Choice "b" is incorrect. Charitable contributions are an itemized deduction unless there is an expectation of commensurate financial return. Choice "c" is incorrect. Federal income taxes paid are not a deductible expense.

Choice "d" is incorrect. Charitable contributions are an itemized deduction unless there is an expectation of commensurate financial return. Federal income taxes paid are not a deductible expense.

QUESTION 15

On December 1, 1992, Michaels, a self-employed cash basis taxpayer, borrowed $100,000 to use in her business. The loan was to be repaid on November 30, 1993. Michaels paid the entire interest of $12,000 on December 1, 1992. What amount of interest was deductible on Michaels' 1993 income tax return?

A. $12,000
B. $11,000
C. $1,000
D. $0

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Prepaid interest must be prorated over the time for which payment is made. This is true for both cash and accrual basis taxpayers. The loan is for 1 month in 1992 and 11 months in 1993. Therefore, 1/12 of the interest is deductible in 1992 and 11/12, or $11,000 is deductible in 1993.
Choices "a", "c", and "d" are incorrect. Prepaid interest must be prorated over the time for which payment is made. This is true for both cash and accrual basis taxpayers.

QUESTION 16
On February 1, 1993, Hall learned that he was bequeathed 500 shares of common stock under his father's will. Hall's father had paid $2,500 for the stock in 1990. Fair market value of the stock on February 1, 1993, the date of his father's death, was $4,000 and had increased to $5,500 six months later. The executor of the estate elected the alternate valuation date for estate tax purposes. Hall sold the stock for $4,500 on June 1, 1993, the date that the executor distributed the stock to him. How much income should Hall include in his 1993 individual income tax return for the inheritance of the 500 shares of stock, which he received from his father's estate?

A. $5,500
B. $4,000
C. $2,500
D. $0

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. There is no income tax on the value of inherited property. The gain on the sale is the difference between the sales price of $4,500 and Hall's basis. Hall's basis is the alternate valuation elected by the executor. This is the value 6 months after date of death or date distributed if before 6 months. The property was distributed 4 months after death and the value that day ($4,500) is used for the basis. $4,500 − $4,500 = 0.
Choice "a" is incorrect. There is no income tax on the value of inherited property.
Choice "b" is incorrect. This is the basis of the stock if the alternate date had not been used. Heirs are not taxed on inheritances. The income or loss results when inherited property is sold.
Choice "c" is incorrect. There is no income tax on the value of inherited property. The gain on the sale is the difference between the sales price of $4,500 and Hall's basis. Hall's basis is the alternate valuation elected by the executor.

QUESTION 17
John and Mary were divorced in 1991. The divorce decree provides that John pay alimony of $10,000 per year, to be reduced by 20% on their child's 18th birthday. During 1992, John paid $7,000 directly to Mary and $3,000 to Spring College for Mary's tuition. What amount of these payments should be reported as income in Mary's 1992 income tax return?

A. $5,600
B. $8,000
C. $8,600
D. $10,000

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Alimony would be income to Mary while child support would not. Funds qualify as child support only if 1) a specific amount is fixed or is contingent on the child's status (e.g., reaching a certain age), 2) it is paid solely for the support of minor children, and 3) it is payable by decree, instrument or agreement. The actual use of the funds is irrelevant to the issue. In this case, $2,000 (20% × $10,000) qualifies as child support. The other $8,000 is alimony, which would be income to Mary.
Choice "a" is incorrect. Take 80% of the $10,000 paid, not 80% of the $7,000 received by Mary.
Choice "c" is incorrect. Only $8,000 would be alimony per the divorce decree (80% × $10,000).
Choice "d" is incorrect. The 20% reduction when the child turns 18 makes 20% of the $10,000 payment, or $2,000, child support, which is nontaxable to Mary.

QUESTION 18 Freeman, a single individual, reported the following income in the current year:

Guaranteed payment from services rendered to a partnership $50,000
Ordinary income from a S corporation $20,000

What amount of Freeman's income is subject to self-employment tax?

A. $0

B. $20,000
C. $50,000 D. $70,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Guaranteed payments are reasonable compensation paid to a partner for services rendered (or use of capital) without regard to his ratio of income. Earned compensation is subject to selfemployment tax. Payments not guaranteed are merely another way to distribute partnership profits. The ordinary income reported from an S corporation are taxable income to the individual or their own individual tax return but is not subject to self-employment tax. The ordinary income reported from a partnership may be subject to self-employment tax (if to a general partner).

QUESTION 19
During 2001, Adler had the following cash receipts:

Wages	$18,000
Interest Income from investments in municipal bonds	400
Unemployment compensation	1,500

What is the total amount that must be included in gross income on Adler's 2001 income tax return?

A. $18,000
B. $18,400
C. $19,500
D. $19,900

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. The wages of $18,000 and unemployment compensation are both includable in gross income on Adler's 2001 income tax return.
Choice "a" is incorrect. The unemployment compensation must be included in gross income.
Choice "b" is incorrect. Municipal bond interest income is excluded from gross income and the unemployment compensation must be included in gross income. Choice "d" is incorrect. Municipal bond interest income is excluded from gross income.

QUESTION 20
DAC Foundation awarded Kent $75,000 in recognition of lifelong literary achievement. Kent was not required to render future services as a condition to receive the $75,000. What condition(s) must have been met for the award to be excluded from Kent's gross income?

I. Kent was selected for the award by DAC without any action on Kent's part.
II. Pursuant to Kent's designation, DAC paid the amount of the award either to a governmental unit or to a charitable organization.

A. I only.
B. II only.
C. Both I and II.
D. Neither I nor II.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Generally, the fair market value of prizes and awards is taxable income. However, an exclusion from income for certain prizes and awards applies where the winner is selected for the award without entering into a contest (i.e., without any action on their part) and then assigns the award directly to a governmental unit or charitable organization. Therefore, conditions "I" and "II" must be met in order for Ken to exclude the award from his gross income.
Choice "a" is incorrect. "II" is a necessary condition as well. See explanation above.
Choice "b" is incorrect. "I" is a necessary condition as well. See explanation above.
Choice "d" is incorrect. "I" and "II" are both necessary conditions. See explanation above.

QUESTION 21
Mosh, a sole proprietor, uses the cash basis of accounting. At the beginning of the current year, accounts receivable were $25,000. During the year, Mosh collected $100,000 from customers. At the end of the year, accounts receivable were $15,000. What was Mosh's gross taxable income for the current year?

A. $75,000
B. $90,000
C. $100,000
D. $110,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. The facts state that cash collections from customers were $100,000 and as a cash basis taxpayer this is the amount of Mosh's gross taxable income for the year. Note that according to the formula BASE - we can determine the amount of sales = $90,000, but that would give us accrual, not cash basis, income.

Beginning A/R	$ 25,000	
Add - Sales	90,000	accrual basis taxable income
	115,000	
Subtract - Cash collections	(100,000)	cash basis taxable income
Ending A/R	$ 15,000	

Choice "a" is incorrect. See explanation above.
Choice "b" is incorrect. $90,000 is the amount of sales that would be Mosh's taxable income if Mosh were an accrual basis taxpayer. Choice "d" is incorrect. See explanation above.

QUESTION 22
Porter was unemployed for part of the year. Porter received $35,000 of wages, $4,000 from a state unemployment compensation plan, and $2,000 from his former employer's company-paid supplemental unemployment benefit plan. What is the amount of Porter's gross income?

A. $35,000
B. $37,000
C. $39,000
D. $41,000

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

RULE: Gross income includes all income unless it is specifically excluded in the tax code.
Choice "d" is correct. Wages and all unemployment compensation are not excluded from being taxable; therefore, there are included in the taxpayer's gross income for tax purposes.

Wages received	$35,000
State unemployment compensation	4,000
Employer's unemployment compensation plan	2,000
	$41,000

Choice "a" is incorrect. All forms of unemployment compensation are included as part of gross income. Choice "b" is incorrect. The $4,000 of state unemployment compensation received is included as part of gross income. Choice "c" is incorrect. The $2,000 of his former employer's company-paid supplemental unemployment benefit plan is included as part of gross income.

QUESTION 23 Which one of the following will result in an accruable expense for an accrual-basis taxpayer?

A. An invoice dated prior to year end but the repair completed after year end.
B. A repair completed prior to year end but not invoiced.
C. A repair completed prior to year end and paid upon completion.
D. A signed contract for repair work to be done and the work is to be completed at a later date.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

RULE: An accruable expense is one is which the services have been received/performed but have not been paid for by the end of the reporting period.

Choice "b" is correct. The facts indicate that a repair was completed prior to year end but not yet invoiced. If it has not yet been invoiced, it is assumed that it has also not yet been paid for. Therefore, this is a situation in which the repair expense would be accrued at year end. Services have been performed, but they have not been paid for, as they have not even been invoiced yet.
Choice "a" is incorrect. If the repair was completed after year end, then the expense is not accruable, as the benefit of the services hasn't been received as of year end. The fact that the repair was invoiced prior to year end does not impact the situation.
Choice "c" is incorrect. If a repair was completed and paid for prior to year end, no accrual is appropriate. On the accrual basis, the expense is taken in the year the repair is completed and the benefit is received. In this case, the account payable was also paid in the same year, but this has no effect on the expense.
Choice "d" is incorrect. The facts indicate that the work is to be completed at a date later than year end. Therefore, the expense is not accruable at year end, as the benefit of the repair hasn't been received as of year end. It is reasonable that a signed contract for the repair work exists, but this has no effect on the accrual.

QUESTION 24
In the current year Jensen had the following items:

Salary	$50,000
Inheritance	25,000
Alimony from ex-spouse	12,000
Child support from ex-spouse	9,000
Capital loss on investment stock sale	(6,000)

What is Jensen's AGI for the current year?

A. $44,000
B. $59,000
C. $62,000
D. $84,000

Correct Answer: B
Section: (none)

Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. The question asks for AGI, but all of the items in the list are items of potential gross income. There are no adjustments included in the list; therefore, in this case, AGI is the same as gross income. The calculation is as follows:

Salary	$50,000
Inheritance	0 [not taxable]
Alimony from ex-spouse	12,000
Child support from ex-spouse	0 [not taxable]
Capital loss on investment stock sale	(3,000) [maximum deductible]
AGI	$59,000

Choices "a", "c", and "d" are incorrect, per the above calculation.

QUESTION 25 Which of the following is subject to the Uniform Capitalization Rules of Code Sec. 263A?

A. Editorial costs incurred by a freelance writer.
B. Research and experimental expenditures.
C. Mine development and exploration costs.
D. Warehousing costs incurred by a manufacturing company with $12 million in annual gross receipts.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Uniform capitalization rules apply to the following: (1) real or tangible personal property produced by the taxpayer for use in his or her trade or business; (2) real or tangible personal property produced by the taxpayer for sale to his or her customers; and (3) real or tangible personal property acquired by the taxpayer for resale, provided the taxpayer's annual average gross receipts for the preceding three years exceeds $10,000,000. Warehousing costs incurred by a manufacturing company (making inventory for sale to its customers) are subject to the Uniform Capitalization Rules.
Further, they are the only item on the list that is real or tangible personal property. In this case, the inventory is not acquired for resale (it is produced by the taxpayer for sale to his or her customers), so the fact that the annual sales are $12,000,000 does not matter in this case. The sales could have been less than $10,000,000 annually, and the Uniform Capitalization Rules would still have applied. Choices "a", "b", and "c" are incorrect, based on the above discussion.

QUESTION 26
Under the uniform capitalization rules applicable to taxpayers with property acquired for resale, which of the following costs should be capitalized with respect to inventory if no exceptions have been met?

	Repackaging costs	Off-site storage costs
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Direct material, direct labor, and factory overhead (applicable indirect costs) are capitalized with respect to inventory under the uniform capitalization rules for property acquired for resale. Applicable indirect costs include depreciation and amortization, insurance, supervisory wages, utilities, spoilage and scrap, design expenses, repair and maintenance and rental of equipment and facilities (including offsite storage), some administrative costs, costs of bonus and other incentive plans, and indirect supplies and other materials (including repackaging costs). Choices "b", "c", and "d" are incorrect, per the above discussion.

QUESTION 27
Smith made a gift of property to Thompson. Smith's basis in the property was $1,200. The fair market value at the time of the gift was $1,400. Thompson sold the property for $2,500. What was the amount of Thompson's gain on the disposition?

A. $0
B. $1,100C. $1,300
D. $2,500

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. The general rule for the basis on gifted property is that the donee receives the property with a rollover cost basis (equal to the donor's basis). An exception exists where the fair market value of the property at the time of the gift is less than the donor's basis. That is not the case in this question; thus, the calculation of the gain on the disposition of the property is:

Amount realized	$2,500
Basis	(1,200)
Gain recognized	$1,300

Choice "a" is incorrect. This choice could be correct if the facts of the question met the exception whereby no gain or loss is recognized when a donee sells gifted property for an amount between the donor's basis and the fair market value at the date of the gift.
Choice "b" is incorrect. This choice uses the basis as the fair market value of the property. Fair market value of property at date of death is used as the basis for inherited property, not gifted property. Choice "d" is incorrect. This choice assumes that Thompson's basis is zero. His basis is $1,200 as indicated above.

QUESTION 28
Leker exchanged a van that was used exclusively for business and had an adjusted tax basis of $20,000 for a new van. The new van had a fair market value of $10,000, and Leker also received $3,000 in cash. What was Leker's tax basis in the acquired van?

A. $20,000 B.
$17,000
C. $13,000
D. $7,000

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. $17,000 is the tax basis in the van.
The basis for like-kind exchanges is computed as follows:

Basis of old property	$20,000
Less: Boot received	(3,000)
New basis	$17,000

The general rule is the gain is recognized to the extent boot is received. As the transaction results in a loss to Leker (he received an asset worth $10,000 plus $3,000 cash less a $20,000 tax basis equals $7,000 loss) no gain is recognized and the $3,000 received reduces his basis in the new asset.
Choice "a" is incorrect. Basis must be reduced by non-like-kind assets (boot) received.
Choice "c" is incorrect. For non-like-kind exchanges, the basis would be the FMV of the assets received ($10,000 FMV plus $3,000 Boot). However, because both assets have similar use, this is a like-kind exchange, which follows the rule above.
Choice "d" is incorrect. The basis of the old property is used to calculate the basis of the new property, less any boot received.

QUESTION 29 Capital
assets include:

A. A corporation's accounts receivable from the sale of its inventory.
B. Seven-year MACRS property used in a corporation's trade or business.
C. A manufacturing company's investment in U.S. Treasury bonds.
D. A corporate real estate developer's unimproved land that is to be subdivided to build homes, which will be sold to customers.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Investment assets of a taxpayer that are not inventory are capital assets. The manufacturing company would have capital assets including an investment in U.S. Treasury bonds. Choice
"a" is incorrect. Accounts receivable generated from the sale of inventory are excluded from the statutory definition of capital assets.
Choice "b" is incorrect. Depreciable property used in a trade or business is excluded from the statutory definition of capital assets.
Choice "d" is incorrect. Land is usually a capital asset, but when it is effectively inventory, as when it is used by a developer to be subdivided, it is excluded from the statutory definition of capital assets.

QUESTION 30
Conner purchased 300 shares of Zinco stock for $30,000 in 1980. On May 23, 1994, Conner sold all the stock to his daughter Alice for $20,000, its then fair market value. Conner realized no other gain or loss during 1994. On July 26, 1994, Alice sold the 300 shares of Zinco for $25,000.
What amount of the loss from the sale of Zinco stock can Conner deduct in 1994?

A. $0
B. $3,000
C. $5,000
D. $10,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Even though Conner has a realized loss of $10,000 on this transaction he cannot deduct the loss since it was incurred in a transaction with his daughter, a related party.
Choice "b" is incorrect. $3,000 is the limit on deductible net capital losses. However, Conner cannot deduct this loss, since it was incurred in a transaction with his daughter, a related party.
Choice "c" is incorrect. Conner's realized loss on the sale is $10,000 ($20,000 proceeds less $30,000 basis). However, Conner cannot deduct this loss, since it was incurred in a transaction with his daughter, a related party. Choice
"d" is incorrect. $10,000 is Conner's realized loss on the sale. However, Conner cannot deduct this loss, since it was incurred in a transaction with his daughter, a related party.

QUESTION 31
Conner purchased 300 shares of Zinco stock for $30,000 in 1980. On May 23, 1994, Conner sold all the stock to his daughter Alice for $20,000, its then fair market value. Conner realized no other gain or loss during 1994. On July 26, 1994, Alice sold the 300 shares of Zinco for $25,000.
What was Alice's recognized gain or loss on her sale?

A. $0
B. $5,000 long-term gain.
C. $5,000 short-term loss.
D. $5,000 long-term loss.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Alice has a realized gain of $5,000 on the transaction: $25,000 sales price less $20,000 purchase price. However, she can reduce the gain, but not below zero, by the amount of loss her father could not deduct on the sale to her. Thus, Alice can reduce her gain by up to $10,000, but not below zero. Here, the gain is $5,000, so it is reduced to zero. Conner should have sold the stock in the open market so that he could deduct the entire loss. Alice could then have purchased the stock in the open market.
Choice "b" is incorrect. $5,000 is Alice's realized long-term gain on the sale. However, she can reduce the gain, but not below zero, by the amount of loss her father could not deduct on the sale to her.
Choice "c" is incorrect. Alice has a realized gain of $5,000 on the sale. However, since she is related to Conner, her holding period includes his holding period. Therefore, her realized gain is long-term. In addition, she can reduce the gain, but not below zero, by the amount of loss her father could not deduct on the sale to her.
Choice "d" is incorrect. Alice can reduce the gain by the amount of loss her father could not deduct on the sale to her. However, she cannot reduce the gain below zero.

QUESTION 32
Smith, an individual calendar-year taxpayer, purchased 100 shares of Core Co. common stock for $15,000 on December 15, 1992, and an additional 100 shares for $13,000 on December 30, 1992. On January 3, 1993, Smith sold the shares purchased on December 15, 1992, for $13,000. What amount of loss from the sale of Core's stock is deductible on Smith's 1992 and 1993 income tax returns?

	1992	1993
A.	$0	$0
B.	$0	$2,000
C.	$1,000	$1,000
D.	$2,000	$0

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. In 1992, no sale of stock occurred so there would be no loss. In 1993, there is a $2,000 loss realized ($15,000 basis less $13,000 received), but it is not deductible because it is a wash sale. A wash sale occurs when a taxpayer sells stock at a loss and invests in substantially identical stock within 30 days before or after the sale. In this case, Smith reinvested in an additional 100 shares four days prior to selling 100 shares of the same stock at a loss. The $2,000 disallowed loss would, however, increase the basis of the new shares by $2,000.
Choice "b" is incorrect. The $2,000 loss realized in 1993 is disallowed under the wash sale rules.
Choice "c" is incorrect. In 1992, there is no loss since no shares were sold. In 1993, the $2,000 loss is disallowed under the wash sale rules. Choice
"d" is incorrect. In 1992, there is no possible loss since no shares were sold.

QUESTION 33
Greller owns 100 shares of Arden Corp., a publicly-traded company, which Greller purchased on January 1, 2001, for $10,000. On January 1, 2003, Arden declared a 2-for-1 stock split when the fair market value (FMV) of the stock was $120 per share. Immediately following the split, the FMV of Arden stock was $62 per share. On February 1, 2003, Greller had his broker specifically sell the 100 shares of Arden stock received in the split when the FMV of the stock was $65 per share. What is the basis of the 100 shares of Arden sold?
A. $5,000
B. $6,000
C. $6,200
D. $6,500

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. The receipt of a nontaxable stock dividend will require the shareholder to spread the basis of his original share over both the original shares and the new shares received resulting in the same total basis, but a lower basis per share of stock held. Therefore, Greller total basis remains the same, $10,000, but is now split between 200 shares (a 2-for-1 split and he originally owned 100 shares).
Therefore, his basis per share goes from $100/share ($10,000/100) to $50/share ($10,000/200).
Consequently, his basis in 100 share is 100 x $50 = $5,000.
Choices "b", "c", and "d" are incorrect per the above explanation.

QUESTION 34 Farr made a gift of stock to her child, Pat. At the date of gift, Farr's stock basis was $10,000 and the stock's fair market value was $15,000. No gift taxes were paid. What is Pat's basis in the stock for computing gain?

A. $0
B. $5,000
C. $10,000
D. $15,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Property acquired as a gift generally retains the rollover cost basis as it had in the hands of the donor at the time of the gift. Basis is increased by any gift tax paid that is attributable to the net appreciation in the value of the gift. Since there were no gift taxes paid, Pat's basis for computing a gain is the rollover cost (basis), $10,000. Choices "a", "b", and "d" are incorrect, per the explanation above.

QUESTION 35
Allen owns 100 shares of Prime Corp., a publicly-traded company, which Allen purchased on January 1, 2001, for $10,000. On January 1, 2003, Prime declared a 2-for-1 stock split when the fair market value (FMV) of the stock was $120 per share. Immediately following the split, the FMV of Prime stock was $62 per share. On February 1, 2003, Allen had his broker specifically sell the 100 shares of Prime stock received in the split when the FMV of the stock was $65 per share. What amount should Allen recognize as long-term capital gain income on his Form 1040, U.S. Individual Income Tax Return, for 2003?

A. $300
B. $750
C. $1,500
D. $2,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. The receipt of a nontaxable stock dividend will require the shareholder to spread the basis of his original shares over both the original shares and the new shares received, resulting in the same total basis but a lower basis per share of stock helD. Therefore, Allen's total basis remains the same, $10,000, but is now split between 200 shares (a 2-for-1 split and he originally owned 100 shares). Therefore, his basis per share goes from $100/share ($10,000/100) to $50/share ($10,000/200).
Consequently, his basis in the 100 shares sold is 100 x $50 = $5,000. Calculate his gain as follows:

Amount realized ($65 x 100)	$6,500
Adjusted Basis (5,000 - calculated above)	(5,000)
Realized & recognized gain	$1,500

Choices "a", "b", and "d" are incorrect.

QUESTION 36

Wallace purchased 500 shares of Kingpin, Inc. 15 years ago for $25,000. Wallace has worked as an owner/employee and owned 40% of the company throughout this time. This year, Kingpin, which is not an S corporation, redeemed 100% of Wallace's stock for $200,000. What is the treatment and amount of income or gain that Wallace should report?

A. $0
B. $175,000 long-term capital gain.
C. $175,000 ordinary income.
D. $200,000 long-term capital gain.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. An investment in a capital asset (e.g., stock) results in the income being capital (either a capital loss or a capital gain). Ownership percentage is not a factor in the calculation, and, in this question, nor is the fact that the corporation is not an S corporation. The calculation is simple:
Wallace invested $25,000 in the stock and received $200,000 for 100% of his investment 15 years later.
The capital gain is $175,000 ($200,000 - $25,000), and it is considered long-term because the stock was held for greater than one year.
Choice "a" is incorrect. There is $175,000 of gain on the transaction ($200,000 - $25,000). This type of transaction is not a transaction that is excluded from tax in the tax code.
Choice "c" is incorrect. An investment in a capital asset (e.g., stock) results in the income being capital (either a capital loss or a capital gain). Although the calculation of the income is correct (i.e., $175,000), ordinary income is not the proper treatment for this transaction.
Choice "d" is incorrect. Although this transaction does result in a long-term capital gain, Wallace has basis in the stock ($25,000), and the gain is calculated as the proceeds from the sale ($200,000) less the basis in the stock.

QUESTION 37 Which of the following sales should be reported as a capital gain?

A. Sale of equipment.
B. Real property subdivided and sold by a dealer.
C. Sale of inventory.
D. Government bonds sold by an individual investor.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Government bonds held by an individual investor are considered capital assets in the hands of the investor. When these types of security investments are sold, the resulting gain or loss is reported as capital. Choice "a" is incorrect. In this case, we must assume that the BEST answer is option "d" (as that option would ALWAYS result in capital gain or loss treatment) and that the examiners are assuming that the equipment is depreciable equipment that has been used in a business for over one year. [If the equipment had been considered a personal asset by the examiners and had sold for a gain, it would also be a capital asset that sold for a capital gain, and there would be two correct answers. Remember that the correct answer is the option that best answers the question.] Depreciable equipment used in a business and held for over one year falls under the category of Section 1245 property. When Section 1245 assets are sold at a gain, all the accumulated depreciation on the asset is recaptured as ordinary income (the same category as the depreciation expense was deducted against), and any remaining gain (typically, in practice, this is not the case, though, as the asset would have had to sell for an amount greater than its purchase price) is capital gain under Code Section 1231. [Note that Section 1245 applies only to gains. If the asset had sold for a loss, the loss would have been ordinary under Section 1231.]
Choice "b" is incorrect. Real property sold by a dealer is considered inventory and results in ordinary income or ordinary losses upon sale. Inventory is not a capital asset and is not afforded the capital gain benefits.
Choice "c" is incorrect. Inventory is not a capital asset and is not afforded the capital gain benefits. The sale of inventory results in ordinary income or loss (e.g., gross profit on sales) being reported on the tax return, as inventory is an asset held for sale in the ordinary course of business.

QUESTION 38
Starr, a self-employed individual, purchased a piece of equipment for use in Starr's business. The costs associated with the acquisition of the equipment were:

Purchase price	$55,000
Delivery charges	725
Installation fees	300
Sales tax	3,400

What is the depreciable basis of the equipment?

A. $55,000
B. $58,400
C. $59,125
D. $59,425

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. The rules for depreciable basis in tax are generally the same as the GAAP rules for capitalizing an asset. The depreciable basis is the cost associated with the purchase of the asset and with getting the asset ready for its intended use. Further improvements are also capitalized, and the basis is reduced for any accumulated depreciation. In this case, the cost of obtaining the equipment and getting the equipment ready for its intended use includes all the items shown above, as follows:

Purchase price	$55,000
Delivery charges	725
Installation fees	300
Sales tax	3,400
Total depreciable basis	$59,425

Choice "a" is incorrect. The costs of delivery charges, installation, and sales tax are all part of the cost of obtaining the asset and getting the asset ready for its intended use. All of these charges are included in the depreciable basis of the equipment.
Choice "b" is incorrect. The costs of delivery charges and installation are both part of the cost of obtaining the asset and getting the asset ready for its intended use. These charges are included in the depreciable basis of the equipment. Choice "c" is incorrect. The cost of installation is part of the cost getting the asset ready for its intended use. This charge is included in the depreciable basis of the equipment.

QUESTION 39 Which of the following statements is the best definition of real property?

A. Real property is only land.
B. Real property is all tangible property including land.
C. Real property is land and intangible property in realized form.
D. Real property is land and everything permanently attached to it.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:
Choice "d" is correct. Real property includes land and all items permanently affixed to the land (e.g., buildings, paving, etc.)
Choice "a" is incorrect. Real property includes more than just the land (as per the explanation above); it includes all items permanently affixed to land.
Choice "b" is incorrect. "All" tangible property could include moveable personal property and is therefore, incorrect. Choice "c" is incorrect. "Intangible property in realized form" is a distracter and a contradiction in terms.

QUESTION 40
Gibson purchased stock with a fair market value of $14,000 from Gibson's adult child for $12,000. The child's cost basis in the stock at the date of sale was $16,000. Gibson sold the same stock to an unrelated party for $18,000. What is Gibson's recognized gain from the sale?

A. $0

B. $2,000C. $4,000
D. $6,000

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Losses are disallowed on most related party sales transactions even if they were made at an arm's length (FMV) price. The basis (and related gain or loss) of the (second) buying relative depends on whether the second relative's resale price is higher, lower, or between the first relative's basis and the lower selling price to the second relative. In this case, the $4,000 capital loss on the sale by Gibson's adult child to Gibson [$12,000 SP - $16,000 Basis] is disallowed. Gibson's basis is determined by his selling price to a third party. In this case, the selling price is $18,000, which is HIGHER than the original basis of Gibson's adult child. Gibson's basis in the stock is, therefore, his adult child's basis of $16,000. Gibson's recognized basis is calculated as follows:

Selling price	$18,000
Basis	(16,000)
Gain	$ 2,000

Choice "a" is incorrect. There would be a zero gain or loss if the selling price were between the adult child's basis and Gibson's purchase price, but this is not the case in the facts.
Choice "c" is incorrect. This answer option uses the fair market value of the stock at the date of purchase as the basis. As is discussed above, the rules do not provide for this treatment. [$18,000 SP - $14,000 FMV = $4,000]
Choice "d" is incorrect. This would be the answer if the basis were Gibson's purchase price of $12,000; however, because the stock sold for more than Gibson's child's basis and the child had a disallowed loss on the sale to Gibson, Gibson is allowed to use his child's original basis of $16,000 as his basis for the stock on the date of the second sale. [$18,000 SP - $12,000 PP = $6,000]

QUESTION 41
An individual had the following capital gains and losses for the year:

Short-term capital loss	$70,000
Long-term gain (unrecaptured Section 1250 at 25%)	56,000
Collectibles gain (28% rate)	10,000
Long-term gain (15% rate)	20,000

What will be the net gain (loss) reported by the individual and at what applicable tax rate(s)?

A. Long-term gain of $16,000 at the 15% rate.
B. Short-term loss of $3,000 at the ordinary rate and long-term capital gain of $86,000 at the 15% rate.
C. Long-term capital gain of $3,000 at the 15% rate, collectibles gain of $10,000 at the 28% rate, and Section 1250 gain of $56,000 at the 25% rate.
D. Short-term loss of $3,000 at the ordinary rate, long-term capital gain of $10,000 at the 15% rate, collectibles gain of $10,000 at the 28% rate, and Section 1250 gain of $56,000 at the 25% rate.

Correct Answer: A
Section: (none)
Explanation
Explanation/Reference:
Explanation:

Choice "a" is correct. Specific netting procedures for capital gains and losses are outlined in the Internal Revenue Code for non-corporate taxpayers.

Gains and losses are netted within each tax rate group (e.g., the 15% rate group). The facts of this question have already performed this step for us.

Short-term Capital Gains and Losses

1. If there are any short-term capital losses (this includes any short-term capital loss carryovers), they are first offset against any short-term gains that would be taxable at the ordinary income rates.
2. Any remaining short-term capital loss is used to offset any long-term capital gains from the 28% grate group (e.g., collectibles).
3. Any remaining short-term capital loss is then used to offset any long-term gains from the 25% group (e.g., un-recaptured Section 1250 gains).
4. Any remaining short-term capital loss is used to offset any long-term capital gains applicable at the lower (e.g., 15%) tax rate.

Long-term Capital Gains and Losses

1. If there are any long-term capital losses (this includes any long-term capital loss carryovers) from the 28% rate group, they are first offset against any net gains from the 25% rate group and then against net gains from the 15% rate group.
2. If there are any long-term capital losses (this includes any long-term capital loss carryovers) from the 15% rate group, they are offset first against any net gains from the 28% rate group and then against net gains from the 25% rate group.

In this case, we are given net short-term capital losses of $70,000 to start with. Following the rules above, this first goes to offset any short-term gains at the ordinary income rates, but there are none in the facts. So, the next step is to offset the losses against any 28% rate gain long-term capital gains. The facts provide that there is $10,000 in gains from collectibles (taxable at the 28% rate). The remaining short-term loss ($60,000) is next used to offset the long-term capital gains at the 25% rate. The facts give us un-recaptured Section 1250 gains of $56,000 (taxed at the 25% tax rate). The remaining short-term capital loss is $4,000 ($70,000 - $10,000 - $56,000 = $4,000). The balance of the short-term capital losses is finally used to offset any capital gains taxed at the 15% tax rate, which the facts give us as $20,000. Therefore, after the $4,000 remaining short-term capital loss is applied to offset the $20,000 long-term capital gain taxed at the 15% tax rate, there is an amount of $16,000 remaining of long-term capital losses to be taxed at the 15% tax rate. Choices "b", "c", and "d" are incorrect, per the ordering rules discussed above.

QUESTION 42 Under a $150,000 insurance policy on her deceased father's life, May Green is to receive $12,000 per year for 15 years. Of the $12,000 received in 1987, the amount subject to income tax is:

A. $0
B. $1,000
C. $2,000
D. $12,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. $2,000.

Death benefit	$150,000
Amount received in 1987	$ 12,000
Less: Return of principal ($150,000 ÷ 15 years)	(10,000)
Taxable interest	$ 2,000

QUESTION 43
Don Wolf became a general partner in Gata Associates on January 1, 1989, with a 5% interest in Gata's profits, losses, and capital. Gata is a distributor of auto parts. Wolf does not materially participate in the partnership business. For the year ended December 31, 1989, Gata had an operating loss of $100,000.
In addition, Gata earned interest of $20,000 on a temporary investment. Gata has kept the principal temporarily invested while awaiting delivery of equipment that is presently on order. The principal will be used to pay for this equipment. Wolf's passive loss for 1989 is:

A. $0
B. $4,000C. $5,000
D. $6,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Wolf's passive loss for 1989 is $5,000 ($100,000 operating loss × 5% interest in partnership).
Choice "a" is incorrect. Wolf did not materially participate in the partnership, so the loss was passive.
Choice "b" is incorrect. Wolf's passive loss of $5,000 could not be reduced by his distributive share of the partnership's "interest income" totaling $1,000. Interest income is considered "portfolio income," and neither the partnership nor a partner can offset it against passive losses.
Choice "d" is incorrect. No items of income or deduction from portfolio income or activities in which the taxpayer materially participates may be combined or offset with passive losses unless the activity generating the loss is completely disposed of in a taxable transaction.

QUESTION 44

Which one of the following statements is correct with regard to an individual taxpayer who has elected to amortize the premium on a bond that yields taxable interest?

A. The amortization is treated as an itemized deduction.
B. The amortization is not treated as a reduction of taxable income.
C. The bond's basis is reduced by the amortization.
D. The bond's basis is increased by the amortization.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. The bond's basis is reduced by the amortization of the premium.
Choice "a" is incorrect. For bonds acquired after 12/31/87, the amortization of the premium is an offset to interest income on the bond rather than a separate interest deduction.
Choice "b" is incorrect. The amortization of the premium will reduce taxable income. Choice "d" is incorrect. The bond's basis will be decreased by the amortization.

QUESTION 45
Cobb, an unmarried individual, had an adjusted gross income of $200,000 in 1990 before any IRA deduction, taxable social security benefits, or passive activity losses. Cobb incurred a loss of $30,000 in 1990 from rental real estate in which he actively participated. What amount of loss attributable to this rental real estate can be used in 1990 as an offset against income from nonpassive sources?

A. $0
B. $12,500C. $25,000
D. $30,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Cobb may not use any of the loss attributable to his rental real estate as an offset against income from nonpassive sources in 1990 because he does not qualify for the "Mom and Pop" exception. Under this exception, up to $25,000 of passive losses and the deduction equivalent of tax credits that are attributable to rental real estate may be used as an offset against income from nonpassive sources. This $25,000 allowance is reduced, but not below zero, by 50% of the amount by which the individual's modified AGI exceeds $100,000. The $25,000 is therefore completely phased out when modified AGI reaches $150,000. Because Cobb's AGI was $200,000, he did not qualify for the exception. Choices "b", "c", and "d" are incorrect. Rental activities are passive activities and generally are not allowed to use any of the loss attributable to the rental activity to offset any income produced from nonpassive sources. There is a limited exception in the case of losses from rental real estate in which the taxpayer actively participates, but Cobb did not qualify for it.

QUESTION 46
Dale received $1,000 in 1990 for jury duty. In exchange for regular compensation from her employer during the period of jury service, Dale was required to remit the entire $1,000 to her employer in 1990. In Dale's 1990 income tax return, the $1,000 jury duty fee should be:

A. Claimed in full as an itemized deduction.
B. Claimed as an itemized deduction to the extent exceeding 2% of adjusted gross income.
C. Deducted from gross income in arriving at adjusted gross income.
D. Included in taxable income without a corresponding offset against other income.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. The $1,000 jury duty fee that was required to be remitted to the employer may be deducted from gross income in arriving at adjusted gross income. This, in effect, washes out the $1,000 income she will have to report as part of gross income for the jury duty fees paid to her.
Choices "a" and "b" are incorrect. The amount remitted is allowed as an adjustment in arriving at AGI, not as an itemized deduction. Choice "d" is incorrect. A corresponding offset is allowed against other income as an adjustment in arriving at AGI.

QUESTION 47
Clark bought Series EE U.S. Savings Bonds after 1989. Redemption proceeds will be used for payment of college tuition for Clark's dependent child. One of the conditions that must be met for tax exemption of accumulated interest on these bonds is that the:

A. Purchaser of the bonds must be the sole owner of the bonds (or joint owner with his or her spouse).
B. Bonds must be bought by a parent (or both parents) and put in the name of the dependent child.
C. Bonds must be bought by the owner of the bonds before the owner reaches the age of 24.
D. Bonds must be transferred to the college for redemption by the college rather than by the owner of the bonds.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. One of the conditions that must be met for tax exemption of accumulated interest on the bonds is that the purchaser of the bonds must be the sole owner of the bonds (or joint owner with his or her spouse). Choice "b" is incorrect. The bonds must be bought and put in the name of the owner or co-owner, not in the name of the dependent child.
Choice "c" is incorrect. The owner must be at least 24 years old before the bonds issue date.
Choice "d" is incorrect. There is no requirement that the bonds must be transferred to the college for redemption by the college rather than by the owner of the bonds.

QUESTION 48 The rule limiting the allowability of passive activity losses and credits applies to:

A. Partnerships.
B. S corporations.
C. Personal service corporations.
D. Widely-held C corporations.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. The rule limiting the allowability of passive activity losses and credits applies to personal service corporations.
Choice "a" is incorrect. The passive activity limitations apply to the various partners in the partnership as opposed to the partnership itself.
Choice "b" is incorrect. The passive activity limitations apply to the various shareholders in the S corporation as opposed to the corporation itself.
Choice "d" is incorrect. The passive activity rules do not apply to widely-held C corporations.

QUESTION 49
Hall, a divorced person and custodian of her 12-year old child, filed her 1990 federal income tax return as head of a household. She submitted the following information to the CPA who prepared her 1990 return:

- The divorce agreement, executed in 1983, provides for Hall to receive $3,000 per month, of which $600 is designated as child support. After the child reaches 18, the monthly payments are to be reduced to $2,400 and are to continue untilremarriage or death. However, for the year 1990, Hall received a total of only $5,000 from her former husband. Hall paid an attorney $2,000 in 1990 in a suit to collect the alimony owed.
- In June 1990, Hall's mother gifted her 100 shares of a listed stock. The donor's basis for this stock, which she bought in 1970, was $4,000, and market value on the date of the gift was $3,000. Hall sold this stock in July 1990 for $3,500. Thedonor paid no gift tax.
- During 1990, Hall spent a total of $1,000 for state lottery tickets. Her lottery winnings in 1990 totaled $200.
- Hall earned a salary of $25,000 in 1990. Hall was not covered by any type of retirement plan, but contributed $2,000 to an IRA in 1990.
- In 1990, Hall sold an antique that she bought in 1980 to display in her home. Hall paid $800 for the antique and sold it for $1,400, using the proceeds to pay a court-ordered judgment.
- Hall paid the following expenses in 1990 pertaining to the home that she owns: realty taxes, $3,400; mortgage interest, $7,000; casualty insurance, $490; assessment by city for construction of a sewer system, $910; interest of $1,000 on apersonal, unsecured bank loan, the proceeds of which were used for home improvements. Hall does not rent out any portion of the home.

What amount should be reported in Hall's 1990 return as alimony income?

A. $36,000
B. $28,800

C. $5,000
D. $0

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. None of the payments received should be considered alimony income. Hall would only claim alimony income if total receipts from her former spouse exceeded $7,200 (the required child support). Rule: In the event of payments consisting of both child support and alimony, child support obligations will be satisfied first.

Amount designated as monthly child support	$ 600
Number of months	x 12
Amount of required child support	$7,200
Payments actually received	($5,000)
Amount of payments considered alimony	$ -0-

QUESTION 50 A cash basis taxpayer should report gross income:

A. Only for the year in which income is actually received in cash.
B. Only for the year in which income is actually received whether in cash or in property.
C. For the year in which income is either actually or constructively received in cash only.
D. For the year in which income is either actually or constructively received, whether in cash or in property.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. A cash basis taxpayer should report gross income for the year in which income is either actually or constructively received, whether in cash or in property.
Choice "a" is incorrect. Income also be constructively received in property - not only actually in cash. Choice "b" is incorrect. Income also be constructively received - not only actually.
Choice "c" is incorrect. Income also be received in property - not only cash.

QUESTION 51
Doris and Lydia are equal partners in the capital and profits of Agee & Nolan, but are otherwise unrelated. The following information pertains to 300 shares of Mast Corp. stock sold by Lydia to Agee & Nolan:

Year of purchase	1980
Year of sale	1988
Basis (cost)	$9,000
Sales price (equal to fair market value)	$4,000

The amount of long-term capital loss that Lydia realized in 1988 on the sale of this stock was:

A. $5,000 B. $3,000
C. $2,500
D. $0

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. $5,000 long term capital loss "realized" in 1988 by Lydia. Be careful, and always check the question being asked. In this case, the question is how much of a capital loss Lydia realized in 1988.

Sales price (FMV)	$4,000
Basis (cost)	(9,000)
Loss realized	(5,000)

Choice "b" is incorrect. $3,000 represents the portion of the $5,000 realized loss that would currently be recognized unless there were additional capital transactions resulting in gains. Remember that the deduction for capital losses for an individual is limited to $3,000 each year.
Choice "c" is incorrect. $2,500 represents the pre-1986 portion of the $5,000 realized loss that would have given rise to a recognized loss. Pre-1986 law required $2 of net long term loss to give the benefit of $1 of tax deduction. Current law gives a dollar-for-dollar deduction limited to $3,000 in any year.
Choice "d" is incorrect. $0 would have been the amount of loss recognized if Lydia owned more than a 50% interest in the partnership. Losses realized on transactions between a partnership and a partner owning more than a 50% interest are not deductible as the parties would be considered related and any realized loss would be disallowed.

QUESTION 52
On December 31, 1989, a building owned by Pine Corp. was totally destroyed by fire. The building had fire insurance coverage up to $500,000. Other pertinent information as of December 31, 1989 follows:

Building, carrying amount	$520,000
Building, fair market value	550,000
Removal and clean-up cost	10,000

During January 1990, before the 1989 financial statements were issued, Pine received insurance proceeds of $500,000. On what amount should Pine base the determination of its loss on involuntary conversion?

A. $520,000
B. $530,000
C. $550,000
D. $560,000

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. $530,000 basis of involuntary converted building.

Building carrying amount	$520,000
Removal and clean up cost	10,000
Basis of involuntary conversion	$530,000
Insurance proceeds	(500,000)
Loss on involuntary conversion	$ 30,000

QUESTION 53 Fred Berk bought a plot of land with a cash payment of $40,000 and a mortgage of $50,000. In addition, Berk paid $200 for a title insurance policy. Berk's basis in this land is:

A. $40,000
B. $40,200
C. $90,000
D. $90,200

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. $90,200 is Berk's basis in the land.
Rule: The basis of the property acquired will be the property's cost consisting of the amount of cash paid plus any amount of related debt assumed. Cost will be adjusted to reflect any additional costs incurred in purchasing the property.

Cash payment	$40,000
Related debt	50,000
Purchase price	$90,000
Add: Cost of title policy	200
Total basis in the land	$90,200

Choices "a", "b", and "c" are incorrect, per the above rule.

QUESTION 54 For a cash basis taxpayer, gain or loss on a year-end sale of listed stock arises on the:

A. Trade date.
B. Settlement date.
C. Date of receipt of cash proceeds.
D. Date of delivery of stock certificate.

Correct Answer: A
Section: (none)
Explanation
Explanation/Reference:
Explanation:

Choice "a" is correct. Trade date.
Gain or loss on a year-end sale of listed stock arises on the trade date.
Rule: Whether on the cash or accrual method of accounting taxpayers who sell stock or securities on an established securities market must recognize gains and losses on the trade date, rather than on the settlement date. Choices "b", "c", and "d" are incorrect, per the above rule.

QUESTION 55
Hall, a divorced person and custodian of her 12-year old child, filed her 1990 federal income tax return as head of a household. She submitted the following information to the CPA who prepared her 1990 return:

• In 1990, Hall sold an antique that she bought in 1980 to display in her home. Hall paid $800 for the antique and sold it for $1,400, using the proceeds to pay a court ordered judgment.
The $600 gain that Hall realized on the sale of the antique should be treated as:

A. Ordinary income.
B. Long-term capital gain.
C. An involuntary conversion.
D. A nontaxable antiquities transaction.

Correct Answer: B

Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. The gain should be treated as a long-term capital gain because the property was held for more than one year and was sold for more than it cost.
Choice "a" is incorrect. Because Hall was not in the business of selling antiques, the profit from the sale will be treated as a gain from the disposition of a capital asset, not ordinary income.
Choice "c" is incorrect. This transaction does not qualify as an involuntary conversion. In order to be treated as an involuntary conversion, the transaction must result from a condemnation of property or a destruction or loss from theft or casualty.
Choice "d" is incorrect. An obvious distracter.

QUESTION 56
Ryan, age 57, is single with no dependents. On July 1, 1997, Ryan's principal residence was sold for the net amount of $500,000 after all selling expenses. Ryan bought the house in 1963 and occupied it until sold. On the date of sale, the house had a basis of $180,000. Ryan does not intend to buy another residence. What is the maximum exclusion of gain on sale of the residence that may be claimed in Ryan's 1997 income tax return?

A. $320,000 B.
$250,000
C. $125,000
D. $0

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. $250,000 maximum exclusion from taxable income.
Rule: An individual may exclude from income up to $250,000 gain provided that the property was the taxpayer's primary residence for 2 of the last 5 years. Married taxpayers may exclude gains up to $500,000.
Choice "a" is incorrect. $320,000. Ryan, age 57, was not married. Thus, his exclusion was limited to $250,000. Choice "c" is incorrect. The $125,000 exclusion was old law and eliminated for sales after 5/6/97.
Choice "d" is incorrect, per the above rule.

QUESTION 57
Among which of the following related parties are losses from sales and exchanges not recognized for tax purposes?

A. Father-in-law and son-in-law.
B. Brother-in-law and sister-in-law.
C. Grandfather and granddaughter.
D. Ancestors, lineal descendants, and all in-laws.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Losses from sales and exchanges are not recognized for tax purposes between grandfather and granddaughter.
Rule: Losses are disallowed on sales between related parties. "Related" includes brothers and sisters, husband-wife, lineal descendants (father, son, grandfather), and entities that are more than 50% owned by individuals, corporations, trusts and/or partnerships.
Choices "a", "b", and "d" are incorrect, because losses from sales and exchanges are recognized for all "in-laws."

QUESTION 58 The uniform capitalization method must be used by:

I. Manufacturers of tangible personal property.
II. Retailers of personal property with $2 million dollars in average annual gross receipts for the 3 preceding years.

A. I only.

B. II only.
C. Both I and II.
D. Neither I nor II.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. I only.
Rule: The uniform capitalization rules apply to the following:

1. Real or tangible personal property produced by the taxpayer for use in a trade or business.
2. Real or tangible personal property produced by the taxpayer for sale to customers.
3. Real or personal property acquired by the taxpayer for resale.
4. However, the uniform capitalization rules do not apply to property acquired for resale if the taxpayer's annual gross receipts for the preceding three tax years do not exceed $10,000,000 (not $2 million).

QUESTION 59
Elm Corp. is an accrual-basis calendar-year C corporation with 100,000 shares of voting common stock issued and outstanding as of December 28, 1996. On Friday, December 29, 1996, Hall surrendered 2,000 shares of Elm stock to Elm in exchange for $33,000 cash. Hall had no direct or indirect interest in Elm after the stock surrender. Additional information follows:

Hall's adjusted basis in 2,000 shares of Elm on December 29, 1996 ($8 per share)	16,000
Elm's accumulated earnings and profits at January 1, 1996	25,000
Elm's 1996 net operating loss.	(7,000)

What amount of income did Hall recognize from the stock surrender?

A. $33,000 dividend.
B. $25,000 dividend.
C. $18,000 capital gain.
D. $17,000 capital gain.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. $17,000 capital gain. Amount realized:

Sale price of 2,000 shares of Elm shares	$33,000
Adjusted basis of stock (2,000 shares @ $8)	(16,000)
Gain realized	$17,000

Choices "a" and "b" are incorrect. Dividends are distributions of earnings. These proceeds are from the sale of stock.
Choice "c" is incorrect, per above. Accumulated earnings and profits do not effect the gain calculation, they only affect the taxability of dividends paid to shareholders.

QUESTION 60
Tom and Joan Moore, both CPAs, filed a joint 1994 federal income tax return showing $70,000 in taxable income. During 1994, Tom's daughter Laura, age 16, resided with Tom. Laura had no income of her own and was Tom's dependent. Determine the amount of income or loss, if any that should be included on page one of the Moores' 1994 Form 1040.
The Moores had no capital loss carryovers from prior years. During 1994, the Moores had the following stock transactions, which resulted in a net capital loss:

	Date acquired	Date sold	Sales price	Cost
Revco	2/1/93	3/17/94	$15,000	$25,000
Abbco	2/18/94	4/1/94	8,000	4,000

A. $0
B. $500
C. $900
D. $1,000
E. $1,250F. $1,300
G. $1,500
H. $2,000
I. $2,500
J. $3,000
K. $10,000
L. $25,000
M. $50,000
N. $55,000 O.
$75,000

Correct Answer: J
Section: (none)
Explanation

Explanation/Reference:
Explanation:

"J" is correct. $3,000. The capital loss on Revco ($10,000 loss) is added to the capital gain on Abbco ($4,000) to produce a net capital loss of ($6,000). The Moores can claim $3,000 of the loss on their 1994 income tax return and carry the balance forward to 1995.

QUESTION 61
Tom and Joan Moore, both CPAs, filed a joint 1994 federal income tax return showing $70,000 in taxable income. During 1994, Tom's daughter Laura, age 16, resided with Tom. Laura had no income of her own and was Tom's dependent. Determine the amount of income or loss, if any that should be included on page one of the Moores' 1994 Form 1040.
In 1992, Joan received an acre of land as an inter-vivos gift from her grandfather. At the time of the gift, the land had a fair market value of $50,000. The grandfather's adjusted basis was $60,000. Joan sold the land in 1994 to an unrelated third party for $56,000.

A. $0
B. $500
C. $900
D. $1,000
E. $1,250F. $1,300
G. $1,500
H. $2,000
I. $2,500
J. $3,000
K. $10,000
L. $25,000
M. $50,000
N. $55,000 O.
$75,000

Correct Answer: A

Section: (none)
Explanation

Explanation/Reference:
Explanation:

"A" is correct. $0. Property received by gift has two bases: one for computing gain and another for computing loss. Joan's basis for gain is the grandfather's adjusted basis ($60,000). Using this basis for gain, Joan has a loss of: $56,000 $60,000 = ($4,000 loss). Joan's basis for loss is the fair market value of the property on the date of the gift ($50,000). Using this basis for loss, Joan has a gain of: $56,000 - $50,000 = $6,000 gain. In this unusual situation, Joan has neither a gain nor a loss, although the transaction must be reported.

QUESTION 62
Tom and Joan Moore, both CPAs, filed a joint 1994 federal income tax return showing $70,000 in taxable income. During 1994, Tom's daughter Laura, age 16, resided with Tom. Laura had no income of her own and was Tom's dependent. Determine the amount of income or loss, if any that should be included on page one of the Moores' 1994 Form 1040.
The Moores received a $500 security deposit on their rental property in 1994. They are required to return the amount to the tenant.

A. $0
B. $500
C. $900
D. $1,000
E. $1,250F. $1,300
G. $1,500
H. $2,000
I. $2,500
J. $3,000
K. $10,000
L. $25,000
M. $50,000
N. $55,000 O.
$75,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

"A" is correct. $0. The security deposit is not taxable income because the Moores are required to return it when the tenant leaves. If the deposit is applied to damages in a later tax year, the portion the Moores retain would be income to them in the year they retain the deposit, and the money they spend to repair the damage would be a deduction to them.

QUESTION 63
Tom and Joan Moore, both CPAs, filed a joint 1994 federal income tax return showing $70,000 in taxable income. During 1994, Tom's daughter Laura, age 16, resided with Tom. Laura had no income of her own and was Tom's dependent. Determine the amount of income or loss, if any that should be included on page one of the Moores' 1994 Form 1040.
Tom's 1994 wages were $53,000. In addition, Tom's employer provided group-term life insurance on Tom's life in excess of $50,000. The value of such excess coverage was $2,000.

A. $0
B. $500
C. $900
D. $1,000
E. $1,250F. $1,300
G. $1,500
H. $2,000
I. $2,500
J. $3,000
K. $10,000
L. $25,000
M. $50,000

N. $55,000 O.
$75,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

"N" is correct. $55,000. The value of employer-provided group term life insurance for which the face amount exceeds $50,000 is taxable income to the insured employee and the $53,000 in wages would both be included on page one, Form 1040.

QUESTION 64
Tom and Joan Moore, both CPAs, filed a joint 1994 federal income tax return showing $70,000 in taxable income. During 1994, Tom's daughter Laura, age 16, resided with Tom. Laura had no income of her own and was Tom's dependent. Determine the amount of income or loss, if any that should be included on page one of the Moores' 1994 Form 1040.
During 1994, the Moores received a $2,500 federal tax refund and a $1,250 state tax refund for 1993 overpayments. In 1993, the Moores were not subject to the alternative minimum tax and were not entitled to any credit against income tax. The Moores' 1993 adjusted gross income was $80,000 and itemized deductions were $1,450 in excess of the standard deduction. The state tax deduction for 1993 was $2,000.

A. $0
B. $500
C. $900
D. $1,000
E. $1,250F. $1,300
G. $1,500
H. $2,000
I. $2,500
J. $3,000
K. $10,000
L. $25,000 M. $50,000
N. $55,000 O.
$75,000

Correct Answer: E
Section: (none)
Explanation

Explanation/Reference:
Explanation:

"E" is correct. $1,250. The Moores itemized deductions in 1993 because such deductions were $1,450 in excess of the standard deduction. The amount of state taxes deducted in 1993 was $2,000, which (along with the fact that the Moores were not subject to alternative minimum tax, which may have reduced their tax benefit) indicates that the Moores received a tax benefit in 1993 from deducting the $1,250 state tax refund they received in 1994. The $1,250 is taxable in 1994.

QUESTION 65
Tom and Joan Moore, both CPAs, filed a joint 1994 federal income tax return showing $70,000 in taxable income. During 1994, Tom's daughter Laura, age 16, resided with Tom. Laura had no income of her own and was Tom's dependent. Determine the amount of income or loss, if any that should be included on page one of the Moores' 1994 Form 1040.
In 1994, Joan received $1,300 in unemployment compensation benefits. Her employer made a $100 contribution to the unemployment insurance fund on her behalf.

A. $0
B. $500
C. $900
D. $1,000
E. $1,250F. $1,300
G. $1,500
H. $2,000
I. $2,500
J. $3,000

K. $10,000
L. $25,000
M. $50,000
N. $55,000 O.
$75,000

Correct Answer: F
Section: (none)
Explanation

Explanation/Reference:
Explanation:

"F" is correct. $1,300. Unemployment compensation benefits are fully taxable (when received by the employee), but contributions made by the employer to the insurance fund are not taxable.

QUESTION 66
Tom and Joan Moore, both CPAs, filed a joint 1994 federal income tax return showing $70,000 in taxable income. During 1994, Tom's daughter Laura, age 16, resided with Tom. Laura had no income of her own and was Tom's dependent. Determine the amount of income or loss, if any that should be included on page one of the Moores' 1994 Form 1040.
The Moores received $8,400 in gross receipts from their rental property during 1994. The expenses for the residential rental property were:

A. $0
B. $500
C. $900
D. $1,000E. $1,250
F. $1,300
G. $1,500
H. $2,000
I. $2,500
J. $3,000
K. $10,000
L. $25,000
M. $50,000
N. $55,000 O.
$75,000

Correct Answer: I
Section: (none)
Explanation

Explanation/Reference:
Explanation:

"I" is correct. $2,500. Rental activity net income is reported on page one; the gross income ($8,400) is fully reportable; and all deductions listed (total = $5,900) are fully deductible for a net of $2,500.

QUESTION 67
Tom and Joan Moore, both CPAs, filed a joint 1994 federal income tax return showing $70,000 in taxable income. During 1994, Tom's daughter Laura, age 16, resided with Tom. Laura had no income of her own and was Tom's dependent. Determine the amount of income or loss, if any that should be included on page one of the Moores' 1994 Form 1040.
The Moores received a stock dividend in 1994 from Ace Corp. They had the option to receive either cash or Ace stock with a fair market value of $900 as of the date of distribution. The par value of the stock was $500.

A. $0
B. $500
C. $900
D. $1,000
E. $1,250F. $1,300
G. $1,500
H. $2,000
I. $2,500
J. $3,000

K. $10,000
L. $25,000
M. $50,000
N. $55,000 O.
$75,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

"C" is correct. $900. If a taxpayer has the option of taking a dividend either in stock or in other property (e.g., cash), the dividend is taxable regardless of the option the taxpayer selects.

QUESTION 68
Tom and Joan Moore, both CPAs, filed a joint 1994 federal income tax return showing $70,000 in taxable income. During 1994, Tom's daughter Laura, age 16, resided with Tom. Laura had no income of her own and was Tom's dependent.
Determine the amount of income or loss, if any that should be included on page one of the Moores' 1994 Form 1040.
In 1994, Joan received $3,500 as beneficiary of the death benefit, which was provided by her brother's employer. Joan's brother did not have a nonforfeitable right to receive the money while living.

A. $0
B. $500 C. $900
D. $1,000
E. $1,250F. $1,300
G. $1,500
H. $2,000
I. $2,500
J. $3,000
K. $10,000
L. $25,000
M. $50,000
N. $55,000 O.
$75,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

"A" is correct. $0. Life insurance proceeds received by reason of the death of the insured are not taxable income to the recipient.

QUESTION 69
Tom and Joan Moore, both CPAs, filed a joint 1994 federal income tax return showing $70,000 in taxable income. During 1994, Tom's daughter Laura, age 16, resided with Tom. Laura had no income of her own and was Tom's dependent.
Determine the amount of income or loss, if any that should be included on page one of the Moores' 1994 Form 1040.
Tom received $10,000, consisting of $5,000 each of principal and interest, when he redeemed a Series EE savings bond in 1994. The bond was issued in his name in 1990 and the proceeds were used to pay for Laura's college tuition. Tom had not elected to report the yearly increases in the value of the bond.

A. $0
B. $500
C. $900
D. $1,000
E. $1,250F. $1,300
G. $1,500
H. $2,000
I. $2,500
J. $3,000

K. $10,000
L. $25,000
M. $50,000
N. $55,000 O.
$75,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

"A" is correct. $0. Generally, if a taxpayer does not make an election to accrue interest income from Series EE bonds, the interest is taxable at the time the bonds are cashed. However, an exception applies in this case because Tom Moore meets the criteria (assume he was 24 years or older in 1990). Savings bonds is tax-exempt when:
(1) It is used to pay for qualified higher-education expenses for the taxpayer, spouse, or dependents;
(2) There is taxpayer or joint ownership with spouse;
(3) The taxpayer is age 24 (or over) when the bonds are issued; and(4) The bonds are acquired after 1989.