CPA-REGULATION Q&As

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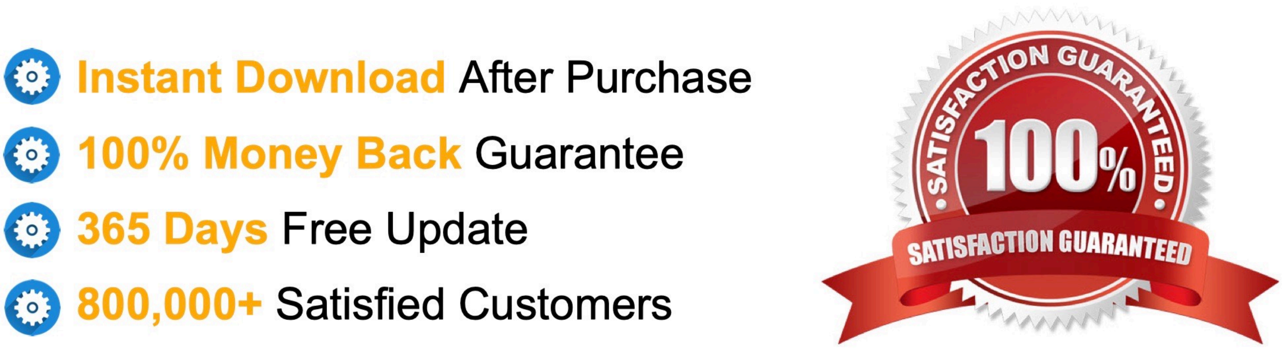

QUESTION 1

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

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 2

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

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 3

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. $2,000

C. $4,000

D. $6,000

Correct Answer: B

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 4

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

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 5

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

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.