CPA-REGULATION Q&As

CPA Regulation

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QUESTION 1

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. $1,250

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: C

"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 2

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

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 3

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

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 4

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

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: 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.

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

QUESTION 5

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

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.