CPA-REGULATION Q&As

CPA Regulation

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QUESTION 1

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

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 2

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. $1,250

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: A

"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 3

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

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 4

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

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 5

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

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.

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