Vendor: Test Prep

Exam Code:CPA-REGULATION

Exam Name:CPA Regulation

Version: Demo

QUESTION 1

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

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 2

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

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 3

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. $4,000

C. $5,000

D. $6,000

Correct Answer: C

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 4

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. $1,250

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

"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.

QUESTION 5

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

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 6

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

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 7

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

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 8

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

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 9

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 10

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 11

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 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

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).