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Question 1

Question Type: MultipleChoice

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?

Options:

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

Answer:

C

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 $100 \times \$50 = \$5,000$. Calculate his gain as follows:

Amount realized ($\$65 \times 100$)	\$6,500
Adjusted Basis (5,000 - calculated above)	<u>(5,000)</u>
Realized & recognized gain	\$1,500

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

Question 2

Question Type: MultipleChoice

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?

Options:

A- \$0

B- \$5,000

C- \$10,000

D- \$15,000

Answer:

C

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 3

Question Type: MultipleChoice

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?

Options:

A- \$5,000

B- \$6,000

C- \$6,200

D- \$6,500

Answer:

A

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 $100 \times \$50 = \$5,000$.

Choices 'b', 'c', and 'd' are incorrect per the above Explanation: .

Question 4

Question Type: MultipleChoice

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?

	<u>1992</u>	<u>1993</u>
A.	\$0	\$0
B.	\$0	\$2,000
C.	\$1,000	\$1,000
D.	\$2,000	\$0

Options:

- A- Option A
- B- Option B
- C- Option C
- D- Option D

Answer:

A

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 5

Question Type: MultipleChoice

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?

Options:

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

Answer:

A

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 6

Question Type: MultipleChoice

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?

Options:

A- \$0

B- \$3,000

C- \$5,000

D- \$10,000

Answer:

A

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.

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