AICPA CPA-Regulation Practice Questions

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Question 1

Question Type: MultipleChoice

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.

In 1994, Joan received $3,500 as beneficiary of the death benefit, which was provided by her brother's employer. Joan's brother did not have a nonforfeitable right to receive the money while living.

Options:

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

Answer:

A

Explanation:

'A' is correct. $0. Life insurance proceeds received by reason of the death of the insured are not taxable income to the recipient.

Question 2

Question Type: MultipleChoice

The uniform capitalization method must be used by:

I Manufacturers of tangible personal property.

II Retailers of personal property with $2 million dollars in average annual gross receipts for the 3 preceding years.

Options:

A- I only.
B- II only.
C- Both I and II
D- Neither I nor II

Answer:

A

Explanation:

Choice 'a' is correct. I only.

Rule: The uniform capitalization rules apply to the following:

1. Real or tangible personal property produced by the taxpayer for use in a trade or business.

2. Real or tangible personal property produced by the taxpayer for sale to customers.

3. Real or personal property acquired by the taxpayer for resale.

4. However, the uniform capitalization rules do not apply to property acquired for resale if the taxpayer's annual gross receipts for the preceding three tax years do not exceed $10,000,000 (not $2 million).

Question 3

Question Type: MultipleChoice

In evaluating the hierarchy of authority in tax law, Which option best carries the greatest authoritative value for tax planning of transactions?

Options:

A- Internal Revenue Code.
B- IRS regulations.
C- Tax court decisions.
D- IRS agents' reports.

Answer:

A

Explanation:

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.

Individual Taxation - Exemptions

Question 4

Question Type: MultipleChoice

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?

Options:

A- $18,000
B- $18,400
C- $19,500
D- $19,900

Answer:

C

Explanation:

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 5

Question Type: MultipleChoice

Adams owns a second residence that is used for both personal and rental purposes. During 2001, Adams used the second residence for 50 days and rented the residence for 200 days. Which of the following statements is correct?

Options:

A- Depreciation may not be deducted on the property under any circumstances.
B- A rental loss may be deducted if rental-related expenses exceed rental income.
C- Utilities and maintenance on the property must be divided between personal and rental use.
D- All mortgage interest and taxes on the property will be deducted to determine the property's net income or loss.

Answer:

C

Explanation:

Choice 'c' is correct. Because the second property was personally used more than 14 days, any net loss from the rental of the property will be disallowed.

All related expenses must be prorated between the personal use portion and the rental activity portion.

Prorated depreciation is permitted for the rental activity.

Question 6

Question Type: MultipleChoice

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?

Options:

A- $5,500
B- $4,000
C- $2,500
D- $0

Answer:

D

Explanation:

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 7

Question Type: MultipleChoice

Barkley owns a vacation cabin that was rented to unrelated parties for 10 days during the year for $2,500. The cabin was used personally by Barkley for three months and left vacant for the rest of the year. Expenses for the cabin were as follows:

Real estate taxes $1,000

Maintenance and utilities $2,000

How much rental income (loss) is included in Barkley's adjusted gross income?

Options:

A- $0
B- $500
C- $(500)
D- $(1,500)

Answer:

A

Explanation:

RULE: If a vacation residence is rented for less than 15 days per year, it is treated as a personal residence. The rental income is excluded from income, and mortgage interest (first or second home) and real estate taxes are allowed as itemized deductions. Depreciation, utilities, and repairs are not deductible.

Choice 'a' is correct. Applying the rule above, if a vacation residence is rented for less than 15 days per year, it is treated as a personal residence. The rental income ($2,500 in this case) is excluded from income. A Schedule E is not filed for this property (i.e., no income is reported, the taxes are reported as itemized deductions, and the maintenance and utilities are not deductible), so the effect on AGI is zero.

Choice 'b' is incorrect. This assumes that the property taxes are reported as itemized deductions but that the rental income ($2,500) less the maintenance and utilities ($2,000) are reported net on Schedule E.

Per the above RULE, the rental income is excluded from income, and the maintenance and utilities are not deductible.

Choice 'c' is incorrect. This assumes that all of the items shown are reported net on the Schedule E-$2,500 - $1,000 - $2,000 = ($500). Per the above RULE, the rental income is excluded from income, the maintenance and utilities are not deductible, and the property taxes are reported on Schedule A as an itemized deduction.

Choice 'd' is incorrect, per the above rule and discussion.

Question 8

Question Type: MultipleChoice

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?

Options:

A- $0
B- $2,000
C- $22,000
D- $24,000

Answer:

B

Explanation:

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 9

Question Type: MultipleChoice

Cobb, an unmarried individual, had an adjusted gross income of $200,000 in 1990 before any IRA deduction, taxable social security benefits, or passive activity losses. Cobb incurred a loss of $30,000 in 1990 from rental real estate in which he actively participated. What amount of loss attributable to this rental real estate can be used in 1990 as an offset against income from nonpassive sources?

Options:

A- $0
B- $12,500
C- $25,000
D- $30,000

Answer:

A

Explanation:

Choice 'a' is correct. Cobb may not use any of the loss attributable to his rental real estate as an offset against income from nonpassive sources in 1990 because he does not qualify for the 'Mom and Pop' exception. Under this exception, up to $25,000 of passive losses and the deduction equivalent of tax credits that are attributable to rental real estate may be used as an offset against income from nonpassive sources. This $25,000 allowance is reduced, but not below zero, by 50% of the amount by which the individual's modified AGI exceeds $100,000. The $25,000 is therefore completely phased out when modified AGI reaches $150,000. Because Cobb's AGI was $200,000, he did not qualify for the exception.

Choices 'b', 'c', and 'd' are incorrect. Rental activities are passive activities and generally are not allowed to use any of the loss attributable to the rental activity to offset any income produced from nonpassive sources. There is a limited exception in the case of losses from rental real estate in which the taxpayer actively participates, but Cobb did not qualify for it.

Question 10

Question Type: MultipleChoice

Among Which option best related parties are losses from sales and exchanges not recognized for tax purposes?

Options:

A- Father-in-law and son-in-law.
B- Brother-in-law and sister-in-law.
C- Grandfather and granddaughter.
D- Ancestors, lineal descendants, and all in-laws.

Answer:

C

Explanation:

Choice 'c' is correct. Losses from sales and exchanges are not recognized for tax purposes between grandfather and granddaughter.

Rule: Losses are disallowed on sales between related parties. 'Related' includes brothers and sisters, husband-wife, lineal descendants (father, son, grandfather), and entities that are more than 50% owned by individuals, corporations, trusts and/or partnerships.

Choices 'a', 'b', and 'd' are incorrect, because losses from sales and exchanges are recognized for all 'in-laws.'

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Question 11

Question Type: MultipleChoice

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.

P2P exams

Options:

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

Answer:

C

Explanation:

'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

Question Type: MultipleChoice

John and Mary were divorced in 1991. The divorce decree provides that John pay alimony of $10,000 per year, to be reduced by 20% on their child's 18th birthday. During 1992, John paid $7,000 directly to Mary and $3,000 to Spring College for Mary's tuition. What amount of these payments should be reported as income in Mary's 1992 income tax return?

Options:

A- $5,600
B- $8,000
C- $8,600
D- $10,000

Answer:

B

Explanation:

Choice 'b' is correct. Alimony would be income to Mary while child support would not. Funds qualify as child support only if 1) a specific amount is fixed or is contingent on the child's status (e.g., reaching a certain age), 2) it is paid solely for the support of minor children, and 3) it is payable by decree, instrument or agreement. The actual use of the funds is irrelevant to the issue. In this case, $2,000 (20% $10,000) qualifies as child support. The other $8,000 is alimony, which would be income to Mary.

Choice 'a' is incorrect. Take 80% of the $10,000 paid, not 80% of the $7,000 received by Mary.

Choice 'c' is incorrect. Only $8,000 would be alimony per the divorce decree (80% $10,000).

Choice 'd' is incorrect. The 20% reduction when the child turns 18 makes 20% of the $10,000 payment, or $2,000, child support, which is nontaxable to Mary.

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