CPA-REGULATION Q&As

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QUESTION 1

Fred Berk bought a plot of land with a cash payment of $40,000 and a mortgage of $50,000. In addition, Berk paid $200 for a title insurance policy. Berk\\'s basis in this land is:

A. $40,000

B. $40,200

C. $90,000

D. $90,200

Correct Answer: D

Choice "d" is correct. $90,200 is Berk\\'s basis in the land.

Rule: The basis of the property acquired will be the property\\'s cost consisting of the amount of cash paid

plus any amount of related debt assumed. Cost will be adjusted to reflect any additional costs incurred in

purchasing the property.

Cash payment	$40,000
Related debt	50,000
Purchase price	$90,000
Add: Cost of title policy	200
Total basis in the land	$90,200

Choices "a", "b", and "c" are incorrect, per the above rule.

QUESTION 2

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?

A. $0

B. $12,500

C. $25,000

D. $30,000

Correct Answer: A

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 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

Hall, a divorced person and custodian of her 12-year old child, filed her 1990 federal income tax return as head of a household. She submitted the following information to the CPA who prepared her 1990 return:

• In 1990, Hall sold an antique that she bought in 1980 to display in her home. Hall paid $800 for the antique and sold it for $1,400, using the proceeds to pay a court ordered judgment.

The $600 gain that Hall realized on the sale of the antique should be treated as:

A. Ordinary income.

B. Long-term capital gain.

C. An involuntary conversion.

D. A nontaxable antiquities transaction.

Correct Answer: B

Choice "b" is correct. The gain should be treated as a long-term capital gain because the property was held for more than one year and was sold for more than it cost. Choice "a" is incorrect. Because Hall was not in the business of selling antiques, the profit from the sale will be treated as a gain from the disposition of a capital asset, not ordinary income. Choice "c" is incorrect. This transaction does not qualify as an involuntary conversion. In order to be treated as an involuntary conversion, the transaction must result from a condemnation of property or a destruction or loss from theft or casualty. Choice "d" is incorrect. An obvious distracter.

QUESTION 5

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?

	1992	1993
A.	$0	$0
B.	$0	$2,000
C.	$1,000	$1,000
D.	$2,000	$0

A. Option A

B. Option B

C. Option C

D. Option D

Correct Answer: A

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.