CPA-REGULATION Q&As

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QUESTION 1

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).

QUESTION 2

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 3

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 4

Rich is a cash basis self-employed air-conditioning repairman with 1993 gross business receipts of $20,000. Rich\\'s cash disbursements were as follows:

Yellow Pages listing	2,000
Estimated federal income taxes on self-employment income	1,000
Business long-distance telephone calls	400
Charitable contributions	200

What amount should Rich report as net self-employment income?

A. $15,100

B. $14,900 C. $14,100

D. $13,900

Correct Answer: A

Choice "a" is correct. Deductions to arrive at net self-employed income include all necessary and ordinary expenses connected with the business. Estimated federal income tax payments are not an expense. Charitable contributions by an individual are only deductible as an itemized deduction on Schedule A. This assumes the contribution was not made with the "expectation of commensurate financial return."

Receipts	$20,000
Parts	(2,500)
Listing	(2,000)
Telephone	(400)
Net self-employment income	$15,100

Choice "b" is incorrect. Charitable contributions are an itemized deduction unless there is an expectation of

commensurate financial return.

Choice "c" is incorrect. Federal income taxes paid are not a deductible expense.

Choice "d" is incorrect. Charitable contributions are an itemized deduction unless there is an expectation of

commensurate financial return. Federal income taxes paid are not a deductible expense.

QUESTION 5

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.