CPA-REGULATION Q&As

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QUESTION 1

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 2

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?

A. $5,000

B. $6,000

C. $6,200

D. $6,500

Correct Answer: A

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 x $50 = $5,000.

Choices "b", "c", and "d" are incorrect per the above explanation.

QUESTION 3

Under a $150,000 insurance policy on her deceased father\\'s life, May Green is to receive $12,000 per year for 15 years. Of the $12,000 received in 1987, the amount subject to income tax is:

A. $0

B. $1,000

C. $2,000

D. $12,000

Correct Answer: C

Choice "c" is correct. $2,000.

Death benefit	$150,000
Amount received in 1987	$ 12,000
Less: Return of principal ($150,000 ÷ 15 years)	(10,000)
Taxable interest	$ 2,000

QUESTION 4

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?

A. $0

B. $3,000

C. $5,000

D. $10,000

Correct Answer: A

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.

QUESTION 5

In which of the following situations may taxpayers file as married filing jointly?

A. Taxpayers who were married but lived apart during the year.

B. Taxpayers who were married but lived under a legal separation agreement at the end of the year.

C. Taxpayers who were divorced during the year.

D. Taxpayers who were legally separated but lived together for the entire year.

Correct Answer: A

RULE: In order to file a joint return, the parties must be MARRIED at the end of the year. Exception: If the parties are married but are LEGALLY SEPARATED under the laws of the state in which they reside, they cannot file a joint return (they will file either under the single or head of household filing status).

Choice "a" is correct. Per the above rule, taxpayers who are married but lived apart during the year are allowed to file a joint return for the year. The fact that they did not live together during the year has no bearing on the issue. Choice "b" is incorrect. Per the above rule, taxpayers who are married but lived under a legal separation agreement at the end of the year may not file a joint return. They will generally file either under the single or head of household filing status. Choice "c" is incorrect. Per the above rule, taxpayers who were divorced during the year may not file a joint return together, as they are not married at the end of the year. [Note, however, that they may become married again in the year and file a joint return with the new spouse.] Choice "d" is incorrect. Per the above rule, taxpayers who were legally separated but lived together for the entire year may not file a joint return. They will generally file either under the single or head of household filing status.