CPA-REGULATION$^{Q\&As}$

CPA Regulation

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QUESTION 1

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 had no capital loss carryovers from prior years. During 1994, the Moores had the following stock transactions, which resulted in a net capital loss:

	Date acquired	Date sold	Sales price	Cost
Revco	2/1/93	3/17/94	$15,000	$25,000
Abbco	2/18/94	4/1/94	8,000	4,000

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: J

"J" is correct. $3,000. The capital loss on Revco ($10,000 loss) is added to the capital gain on Abbco ($4,000) to produce a net capital loss of ($6,000). The Moores can claim $3,000 of the loss on their 1994 income tax return and carry the balance forward to 1995.

QUESTION 2

Smith made a gift of property to Thompson. Smith\\'s basis in the property was $1,200. The fair market value at the time of the gift was $1,400. Thompson sold the property for $2,500. What was the amount of Thompson\\'s gain on the disposition?

A. $0

B. $1,100

C. $1,300

D. $2,500

Correct Answer: C

Choice "c" is correct. The general rule for the basis on gifted property is that the donee receives the property with a rollover cost basis (equal to the donor\\'s basis). An exception exists where the fair market value of the property at the time of the gift is less than the donor\\'s basis. That is not the case in this question; thus, the calculation of the gain on the disposition of the property is:

Amount realized	$2,500
Basis	(1,200)
Gain recognized	$1,300

Choice "a" is incorrect. This choice could be correct if the facts of the question met the exception whereby no gain or loss is recognized when a donee sells gifted property for an amount between the donor\\'s basis and the fair market value at the date of the gift. Choice "b" is incorrect. This choice uses the basis as the fair market value of the property. Fair market value of property at date of death is used as the basis for inherited property, not gifted property. Choice "d" is incorrect. This choice assumes that Thompson\\'s basis is zero. His basis is $1,200 as indicated above.

QUESTION 3

For a cash basis taxpayer, gain or loss on a year-end sale of listed stock arises on the:

A. Trade date.

B. Settlement date.

C. Date of receipt of cash proceeds.

D. Date of delivery of stock certificate.

Correct Answer: A

Choice "a" is correct. Trade date.

Gain or loss on a year-end sale of listed stock arises on the trade date.

Rule: Whether on the cash or accrual method of accounting taxpayers who sell stock or securities on an established securities market must recognize gains and losses on the trade date, rather than on the

settlement date.

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

QUESTION 4

Which of the following is subject to the Uniform Capitalization Rules of Code Sec. 263A?

A. Editorial costs incurred by a freelance writer.

B. Research and experimental expenditures.

C. Mine development and exploration costs.

D. Warehousing costs incurred by a manufacturing company with $12 million in annual gross receipts.

Correct Answer: D

Choice "d" is correct. Uniform capitalization rules apply to the following: (1) real or tangible personal property produced by the taxpayer for use in his or her trade or business; (2) real or tangible personal property produced by the taxpayer for sale to his or her customers; and (3) real or tangible personal property acquired by the taxpayer for resale, provided the taxpayer\\'s annual average gross receipts for the preceding three years exceeds $10,000,000. Warehousing costs incurred by a manufacturing company (making inventory for sale to its customers) are subject to the Uniform Capitalization Rules. Further, they are the only item on the list that is real or tangible personal property. In this case, the inventory is not acquired for resale (it is produced by the taxpayer for sale to his or her customers), so the fact that the annual sales are $12,000,000 does not matter in this case. The sales could have been less than $10,000,000 annually, and the Uniform Capitalization Rules would still have applied. Choices "a", "b", and "c" are incorrect, based on the above discussion.

QUESTION 5

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.