CPA-REGULATION[Q&As]

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QUESTION 1

Which payment(s) is(are) included in a recipient\\'s gross income?

I. Payment to a graduate assistant for a part-time teaching assignment at a university. Teaching is not a requirement toward obtaining the degree.

II.

A grant to a Ph.D. candidate for his participation in a university-sponsored research project for the benefit of the university.

A.

I only.

B.

II only.

C.

Both I and II.

D.

Neither I nor II.

Correct Answer: C

Choice "c" is correct.

I. A payment to a student for a part-time teaching assignment is taxable income just as a payment for any other campus job would be. This is not a scholarship or fellowship. II. There is no exclusion in the tax law for amounts paid to a degree candidate for participation in university-sponsored research.

QUESTION 2

An individual had the following capital gains and losses for the year:

Short-term capital loss	$70,000
Long-term gain (unrecaptured Section 1250 at 25%)	56,000
Collectibles gain (28% rate)	10,000
Long-term gain (15% rate)	20,000

What will be the net gain (loss) reported by the individual and at what applicable tax rate(s)?

A. Long-term gain of $16,000 at the 15% rate.

B. Short-term loss of $3,000 at the ordinary rate and long-term capital gain of $86,000 at the 15% rate.

C. Long-term capital gain of $3,000 at the 15% rate, collectibles gain of $10,000 at the 28% rate, and Section 1250 gain of $56,000 at the 25% rate.

D. Short-term loss of $3,000 at the ordinary rate, long-term capital gain of $10,000 at the 15% rate, collectibles gain of $10,000 at the 28% rate, and Section 1250 gain of $56,000 at the 25% rate.

Correct Answer: A

Choice "a" is correct. Specific netting procedures for capital gains and losses are outlined in the Internal Revenue Code for non-corporate taxpayers.

Gains and losses are netted within each tax rate group (e.g., the 15% rate group). The facts of this question have already performed this step for us.

Short-term Capital Gains and Losses

1.

If there are any short-term capital losses (this includes any short-term capital loss carryovers), they are first offset against any short-term gains that would be taxable at the ordinary income rates.

2.

Any remaining short-term capital loss is used to offset any long-term capital gains from the 28% grate group (e.g., collectibles).

3.

Any remaining short-term capital loss is then used to offset any long-term gains from the 25% group (e.g., un-recaptured Section 1250 gains).

4.

Any remaining short-term capital loss is used to offset any long-term capital gains applicable at the lower (e.g., 15%) tax rate.

Long-term Capital Gains and Losses

1.

If there are any long-term capital losses (this includes any long-term capital loss carryovers) from the

28% rate group, they are first offset against any net gains from the 25% rate group and then against net gains from the 15% rate group.

2.

If there are any long-term capital losses (this includes any long-term capital loss carryovers) from the 15% rate group, they are offset first against any net gains from the 28% rate group and then against net gains from the 25% rate group.

In this case, we are given net short-term capital losses of $70,000 to start with. Following the rules above, this first goes to offset any short-term gains at the ordinary income rates, but there are none in the facts. So, the next step is to offset the losses against any 28% rate gain long-term capital gains. The facts provide that there is $10,000 in gains from collectibles (taxable at the 28% rate). The remaining short-term loss ($60,000) is next used to offset the long-term capital gains at the 25% rate. The facts give us unrecaptured Section 1250 gains of $56,000 (taxed at the 25% tax rate). The remaining short-term capital loss is $4,000 ($70,000 - $10,000 - $56,000 = $4,000). The balance of the short-term capital losses is finally used to offset any capital gains taxed at the 15% tax rate, which the facts give us as $20,000.

Therefore, after the $4,000 remaining short-term capital loss is applied to offset the $20,000 long-term capital gain taxed at the 15% tax rate, there is an amount of $16,000 remaining of long-term capital losses to be taxed at the 15% tax rate. Choices "b", "c", and "d" are incorrect, per the ordering rules discussed above.

QUESTION 3

Freeman, a single individual, reported the following income in the current year:

Guaranteed payment from services rendered to a partnership $50,000 Ordinary income from a S corporation $20,000

What amount of Freeman\\'s income is subject to self-employment tax?

A. $0

B. $20,000

C. $50,000

D. $70,000

Correct Answer: C

Choice "c" is correct. Guaranteed payments are reasonable compensation paid to a partner for services rendered (or use of capital) without regard to his ratio of income. Earned compensation is subject to selfemployment tax. Payments not guaranteed are merely another way to distribute partnership profits. The ordinary income reported from an S corporation are taxable income to the individual or their own individual tax return but is not subject to self-employment tax. The ordinary income reported from a partnership may be subject to self-employment tax (if to a general partner).

QUESTION 4

A cash basis taxpayer should report gross income:

A. Only for the year in which income is actually received in cash.

B. Only for the year in which income is actually received whether in cash or in property.

C. For the year in which income is either actually or constructively received in cash only.

D. For the year in which income is either actually or constructively received, whether in cash or in property.

Correct Answer: D

Choice "d" is correct. A cash basis taxpayer should report gross income for the year in which income is

either actually or constructively received, whether in cash or in property.

Choice "a" is incorrect. Income also be constructively received in property - not only actually in cash.

Choice "b" is incorrect. Income also be constructively received - not only actually. Choice "c" is incorrect. Income also be received in property - not only cash.

QUESTION 5

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?

A. $0

B. $500

C. $(500)

D. $(1,500)

Correct Answer: A

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.