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Exam : **CPA-Regulation**

Title : Certified Public Accountant
CPA Regulation

Vendor : AICPA

Version : DEMO

NO.1 Elm Corp. is an accrual-basis calendar-year C corporation with 100,000 shares of voting common stock issued and outstanding as of December 28, 1996. On Friday, December 29, 1996, Hall surrendered 2,000 shares of Elm stock to Elm in exchange for \$33,000 cash. Hall had no direct or indirect interest in Elm after the stock surrender. Additional information follows:

Hall's adjusted basis in 2,000 shares of Elm on December 29, 1996 (\$8 per share)	16,000
Elm's accumulated earnings and profits at January 1, 1996	25,000
Elm's 1996 net operating loss	(7,000)

What amount of income did Hall recognize from the stock surrender?

- A. \$33,000 dividend.
- B. \$18,000 capital gain.
- C. \$17,000 capital gain.
- D. \$25,000 dividend.

Answer: C

Explanation

Choice "d" is correct. \$17,000 capital gain.

Sale price of 2,000 shares of Elm shares	\$33,000
Adjusted basis of stock (2,000 shares @ \$8)	<u>(16,000)</u>
Gain realized	<u>\$17,000</u>

Amount realized:

Choices "a" and "b" are incorrect. Dividends are distributions of earnings. These proceeds are from the sale of stock.

Choice "c" is incorrect, per above. Accumulated earnings and profits do not effect the gain calculation, they only affect the taxability of dividends paid to shareholders.

NO.2 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. \$12,000
- B. \$2,000
- C. \$1,000
- D. \$0

Answer: B

Explanation

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

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

NO.3 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 was Alice's recognized gain or loss on her sale?

- A. \$5,000 short-term loss.
- B. \$5,000 long-term gain.
- C. \$5,000 long-term loss.
- D. \$0

Answer: D

Explanation

Choice "a" is correct. Alice has a realized gain of \$5,000 on the transaction: \$25,000 sales price less \$20,000 purchase price. However, she can reduce the gain, but not below zero, by the amount of loss her father could not deduct on the sale to her. Thus, Alice can reduce her gain by up to \$10,000, but not below zero. Here, the gain is \$5,000, so it is reduced to zero. Conner should have sold the stock in the open market so that he could deduct the entire loss. Alice could then have purchased the stock in the open market.

Choice "b" is incorrect. \$5,000 is Alice's realized long-term gain on the sale. However, she can reduce the gain, but not below zero, by the amount of loss her father could not deduct on the sale to her.

Choice "c" is incorrect. Alice has a realized gain of \$5,000 on the sale. However, since she is related to Conner, her holding period includes his holding period. Therefore, her realized gain is long-term. In addition, she can reduce the gain, but not below zero, by the amount of loss her father could not deduct on the sale to her.

Choice "d" is incorrect. Alice can reduce the gain by the amount of loss her father could not deduct on the sale to her. However, she cannot reduce the gain below zero.

NO.4 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.

Tom's 1994 wages were \$53,000. In addition, Tom's employer provided group-term life insurance on Tom's life in excess of \$50,000. The value of such excess coverage was \$2,000.

- A. \$25,000
- B. \$2,000
- C. \$0
- D. \$3,000
- E. \$50,000
- F. \$10,000
- G. \$2,500
- H. \$1,250
- I. \$1,000
- J. \$1,300
- K. \$900
- L. \$1,500
- M. \$75,000
- N. \$55,000
- O. \$500

Answer: C

Explanation

"N" is correct. \$55,000. The value of employer-provided group term life insurance for which the face amount exceeds \$50,000 is taxable income to the insured employee and the \$53,000 in wages would both be included on page one, Form 1040.

NO.5 Which of the following statements is the best definition of real property?

- A.** Real property is only land.
- B.** Real property is land and intangible property in realized form.
- C.** Real property is land and everything permanently attached to it.
- D.** Real property is all tangible property including land.

Answer: C

Explanation

Choice "d" is correct. Real property includes land and all items permanently affixed to the land (e.g., buildings, paving, etc.) Choice "a" is incorrect. Real property includes more than just the land (as per the explanation above); it includes all items permanently affixed to land.

Choice "b" is incorrect. "All" tangible property could include moveable personal property and is therefore, incorrect.

Choice "c" is incorrect. "Intangible property in realized form" is a distracter and a contradiction in terms.

NO.6 Adams owns a second residence that is used for both personal and rental purposes. During 2001, Adams used the second residence for 50 days and rented the residence for 200 days. Which of the following statements is correct?

- A.** All mortgage interest and taxes on the property will be deducted to determine the property's net income or loss.
- B.** Depreciation may not be deducted on the property under any circumstances.
- C.** Utilities and maintenance on the property must be divided between personal and rental use.
- D.** A rental loss may be deducted if rental-related expenses exceed rental income.

Answer: C

Explanation

Choice "c" is correct. Because the second property was personally used more than 14 days, any net loss from the rental of the property will be disallowed.

All related expenses must be prorated between the personal use portion and the rental activity portion.

Prorated depreciation is permitted for the rental activity.

NO.7 Allen owns 100 shares of Prime Corp., a publicly-traded company, which Allen purchased on January

1, 2001, for \$10,000. On January 1, 2003, Prime 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 Prime stock was \$62 per share. On February 1, 2003, Allen had his broker specifically sell the 100 shares of Prime stock received in the split when the FMV of the stock was \$65 per share. What amount should Allen recognize as long-term capital gain income on his Form 1040, U.S. Individual Income Tax Return, for 2003?

- A.** \$750

- B. \$300
- C. \$2,000
- D. \$1,500

Answer: D

Explanation

Choice "c" is correct. The receipt of a nontaxable stock dividend will require the shareholder to spread the basis of his original shares 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, Allen's 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 the 100 shares sold is $100 \times \$50 = \$5,000$. Calculate his gain as follows:

Amount realized ($\$65 \times 100$)	\$6,500
Adjusted Basis (5,000 - calculated above)	(5,000)
Realized & recognized gain	\$1,500

Choices "a", "b", and "d" are incorrect.