

# AICPA

*CPA-Regulation  
CPA Regulation Exam*



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## Question: 1

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

**Answer: A**

Explanation:

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: 2

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

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**Answer: A**

Explanation:

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	<u>\$15,100</u>

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: 3**

On December 1, 1992, Michaels, a self-employed cash basis taxpayer, borrowed \$100,000 to use in her business. The loan was to be repaid on November 30, 1993. Michaels paid the entire interest of \$12,000 on December 1, 1992. What amount of interest was deductible on Michaels' 1993 income tax return?

- A. \$12,000
- B. \$11,000
- C. \$1,000
- D. \$0

**Answer: B**

Explanation:

Choice "b" is correct. Prepaid interest must be prorated over the time for which payment is made. This is true for both cash and accrual basis taxpayers. The loan is for 1 month in 1992 and 11 months in 1993. Therefore, 1/12 of the interest is deductible in 1992 and 11/12, or \$11,000 is deductible in 1993.

Choices "a", "c", and "d" are incorrect. Prepaid interest must be prorated over the time for which payment is made. This is true for both cash and accrual basis taxpayers.

### Question: 4

On February 1, 1993, Hall learned that he was bequeathed 500 shares of common stock under his father's will. Hall's father had paid \$2,500 for the stock in 1990. Fair market value of the stock on

February 1, 1993, the date of his father's death, was \$4,000 and had increased to \$5,500 six months later. The executor of the estate elected the alternate valuation date for estate tax purposes. Hall sold the stock for \$4,500 on June 1, 1993, the date that the executor distributed the stock to him. How much income should Hall include in his 1993 individual income tax return for the inheritance of the 500 shares of stock, which he received from his father's estate?

- A. \$5,500
- B. \$4,000
- C. \$2,500
- D. \$0

**Answer: D**

Explanation:

Choice "d" is correct. There is no income tax on the value of inherited property. The gain on the sale is the difference between the sales price of \$4,500 and Hall's basis. Hall's basis is the alternate valuation elected by the executor. This is the value 6 months after date of death or date distributed if before 6 months. The property was distributed 4 months after death and the value that day (\$4,500) is used for the basis.  $\$4,500 - \$4,500 = 0$ .

Choice "a" is incorrect. There is no income tax on the value of inherited property.

Choice "b" is incorrect. This is the basis of the stock if the alternate date had not been used.

Heirs are not taxed on inheritances. The income or loss results when inherited property is sold.

Choice "c" is incorrect. There is no income tax on the value of inherited property. The gain on the sale is the difference between the sales price of \$4,500 and Hall's basis. Hall's basis is the alternate valuation elected by the executor.

### Question: 5

John and Mary were divorced in 1991. The divorce decree provides that John pay alimony of \$10,000 per year, to be reduced by 20% on their child's 18th birthday. During 1992, John paid \$7,000 directly to Mary and \$3,000 to Spring College for Mary's tuition. What amount of these payments should be reported as income in Mary's 1992 income tax return?

- A. \$5,600
- B. \$8,000
- C. \$8,600

D. \$10,000

**Answer: B**

Explanation:

Choice "b" is correct. Alimony would be income to Mary while child support would not. Funds qualify as child support only if 1) a specific amount is fixed or is contingent on the child's status (e.g., reaching a certain age), 2) it is paid solely for the support of minor children, and 3) it is payable by decree, instrument or agreement. The actual use of the funds is irrelevant to the issue. In this case, \$2,000 ( $20\% \times \$10,000$ ) qualifies as child support. The other \$8,000 is alimony, which would be income to Mary.

Choice "a" is incorrect. Take 80% of the \$10,000 paid, not 80% of the \$7,000 received by Mary.

Choice "c" is incorrect. Only \$8,000 would be alimony per the divorce decree ( $80\% \times \$10,000$ ).

Choice "d" is incorrect. The 20% reduction when the child turns 18 makes 20% of the \$10,000 payment, or \$2,000, child support, which is nontaxable to Mary.

### Question: 6

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

**Answer: C**

Explanation:

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: 7

During 2001, Adler had the following cash receipts:

Wages	\$18,000
Interest Income from investments in municipal bonds	400
Unemployment compensation	1,500

What is the total amount that must be included in gross income on Adler's 2001 income tax return?

- A. \$18,000
- B. \$18,400
- C. \$19,500
- D. \$19,900

**Answer: C**

Explanation:

Choice "c" is correct. The wages of \$18,000 and unemployment compensation are both includable in gross income on Adler's 2001 income tax return.

Choice "a" is incorrect. The unemployment compensation must be included in gross income.

Choice "b" is incorrect. Municipal bond interest income is excluded from gross income and the unemployment compensation must be included in gross income.

Choice "d" is incorrect. Municipal bond interest income is excluded from gross income.

### Question: 8

Mosh, a sole proprietor, uses the cash basis of accounting. At the beginning of the current year, accounts receivable were \$25,000. During the year, Mosh collected \$100,000 from customers. At the end of the year, accounts receivable were \$15,000. What was Mosh's gross taxable income for the current year?

- A. \$75,000
- B. \$90,000
- C. \$100,000
- D. \$110,000

**Answer: C**

Explanation:

Choice "c" is correct. The facts state that cash collections from customers were \$100,000 and as a cash basis taxpayer this is the amount of Mosh's gross taxable income for the year. Note that according to the formula BASE - we can determine the amount of sales = \$90,000, but that would give us accrual, not cash basis, income.

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<b>Beginning A/R</b>	<b>\$ 25,000</b>	
<b>Add - Sales</b>	<u><b>90,000</b></u>	<b>accrual basis taxable income</b>
	<b>115,000</b>	
<b>Subtract - Cash collections</b>	<u><b>(100,000)</b></u>	<b>cash basis taxable income</b>
<b>Ending A/R</b>	<b>\$ 15,000</b>	

Choice "a" is incorrect. See Explanation: above.

Choice "b" is incorrect. \$90,000 is the amount of sales that would be Mosh's taxable income if Mosh were an accrual basis taxpayer.

Choice "d" is incorrect. See Explanation: above.

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