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QUESTION 1

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

Correct Answer: C

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.

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

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.

QUESTION 2

Dale received \$1,000 in 1990 for jury duty. In exchange for regular compensation from her employer during the period of jury service, Dale was required to remit the entire \$1,000 to her employer in 1990. In Dale's 1990 income tax return, the \$1,000 jury duty fee should be:

- A. Claimed in full as an itemized deduction.
- B. Claimed as an itemized deduction to the extent exceeding 2% of adjusted gross income.
- C. Deducted from gross income in arriving at adjusted gross income.
- D. Included in taxable income without a corresponding offset against other income.

Correct Answer: C

Choice "c" is correct. The \$1,000 jury duty fee that was required to be remitted to the employer may be deducted from gross income in arriving at adjusted gross income. This, in effect, washes out the \$1,000 income she will have to report as part of gross income for the jury duty fees paid to her. Choices "a" and "b" are incorrect. The amount remitted is allowed as an adjustment in arriving at AGI, not as an itemized deduction. Choice "d" is incorrect. A corresponding offset is allowed against other income as an adjustment in arriving at AGI.

QUESTION 3

Don Wolf became a general partner in Gata Associates on January 1, 1989, with a 5% interest in Gata's profits, losses, and capital. Gata is a distributor of auto parts. Wolf does not materially participate in the partnership business. For the year ended December 31, 1989, Gata had an operating loss of \$100,000. In addition, Gata earned interest of \$20,000 on a temporary investment. Gata has kept the principal temporarily invested while awaiting delivery of equipment that is presently on order. The principal will be used to pay for this equipment. Wolf's passive loss for 1989 is:

- A. \$0
- B. \$4,000
- C. \$5,000
- D. \$6,000

Correct Answer: C

Choice "c" is correct. Wolf's passive loss for 1989 is \$5,000 (\$100,000 operating loss × 5% interest in partnership).

Choice "a" is incorrect. Wolf did not materially participate in the partnership, so the loss was passive.

Choice "b" is incorrect. Wolf's passive loss of \$5,000 could not be reduced by his distributive share of the partnership's "interest income" totaling \$1,000. Interest income is considered "portfolio income," and neither the partnership nor a partner can offset it against passive losses.

Choice "d" is incorrect. No items of income or deduction from portfolio income or activities in which the taxpayer materially participates may be combined or offset with passive losses unless the activity generating the loss is completely disposed of in a taxable transaction.

QUESTION 4

Under the uniform capitalization rules applicable to property acquired for resale, which of the following costs should be capitalized with respect to inventory if no exceptions are met?

	<u>Marketing costs</u>	<u>Off-site storage costs</u>
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

A. Option A

B. Option B

C. Option C

D. Option D

Correct Answer: D

Choice "d" is correct. Under the uniform capitalization rules, purchasers of inventory for resale may deduct their marketing costs but must capitalize their off-site storage costs.

Choices "a", "b", and "c" are incorrect. Marketing costs are deductible, but off-site storage must be capitalized.

QUESTION 5

Hall, a divorced person and custodian of her 12-year old child, filed her 1990 federal income tax return as head of a household. She submitted the following information to the CPA who prepared her 1990 return:

- In 1990, Hall sold an antique that she bought in 1980 to display in her home. Hall paid \$800 for the antique and sold it for \$1,400, using the proceeds to pay a court ordered judgment.

The \$600 gain that Hall realized on the sale of the antique should be treated as:

- A. Ordinary income.
- B. Long-term capital gain.
- C. An involuntary conversion.
- D. A nontaxable antiquities transaction.

Correct Answer: B

Choice "b" is correct. The gain should be treated as a long-term capital gain because the property was held for more than one year and was sold for more than it cost. Choice "a" is incorrect. Because Hall was not in the business of selling antiques, the profit from the sale will be treated as a gain from the disposition of a capital asset, not ordinary income. Choice "c" is incorrect. This transaction does not qualify as an involuntary conversion. In order to be treated as an

involuntary conversion, the transaction must result from a condemnation of property or a destruction or loss from theft or casualty. Choice "d" is incorrect. An obvious distracter.

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