CPA-REGULATION[Q&As]

CPA Regulation

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QUESTION 1

In which of the following situations may taxpayers file as married filing jointly?

A. Taxpayers who were married but lived apart during the year.

B. Taxpayers who were married but lived under a legal separation agreement at the end of the year.

C. Taxpayers who were divorced during the year.

D. Taxpayers who were legally separated but lived together for the entire year.

Correct Answer: A

RULE: In order to file a joint return, the parties must be MARRIED at the end of the year. Exception: If the parties are married but are LEGALLY SEPARATED under the laws of the state in which they reside, they cannot file a joint return (they will file either under the single or head of household filing status).

Choice "a" is correct. Per the above rule, taxpayers who are married but lived apart during the year are allowed to file a joint return for the year. The fact that they did not live together during the year has no bearing on the issue. Choice "b" is incorrect. Per the above rule, taxpayers who are married but lived under a legal separation agreement at the end of the year may not file a joint return. They will generally file either under the single or head of household filing status. Choice "c" is incorrect. Per the above rule, taxpayers who were divorced during the year may not file a joint return together, as they are not married at the end of the year. [Note, however, that they may become married again in the year and file a joint return with the new spouse.] Choice "d" is incorrect. Per the above rule, taxpayers who were legally separated but lived together for the entire year may not file a joint return. They will generally file either under the single or head of household filing status.

QUESTION 2

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.

QUESTION 3

DAC Foundation awarded Kent $75,000 in recognition of lifelong literary achievement. Kent was not required to render future services as a condition to receive the $75,000. What condition(s) must have been met for the award to be excluded from Kent\\'s gross income?

I. Kent was selected for the award by DAC without any action on Kent\\'s part.

II.

Pursuant to Kent\\'s designation, DAC paid the amount of the award either to a governmental unit or to a charitable organization.

A.

I only.

B.

II only.

C.

Both I and II.

D.

Neither I nor II.

Correct Answer: C

Choice "c" is correct. Generally, the fair market value of prizes and awards is taxable income. However, an

exclusion from income for certain prizes and awards applies where the winner is selected for the award

without entering into a contest (i.e., without any action on their part) and then assigns the award directly to

a governmental unit or charitable organization. Therefore, conditions "I" and "II" must be met in order for

Ken to exclude the award from his gross income.

Choice "a" is incorrect. "II" is a necessary condition as well. See explanation above.

Choice "b" is incorrect. "I" is a necessary condition as well. See explanation above.

Choice "d" is incorrect. "I" and "II" are both necessary conditions. See explanation above.

QUESTION 4

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 5

Doris and Lydia are equal partners in the capital and profits of Agee and Nolan, but are otherwise unrelated. The following information pertains to 300 shares of Mast Corp. stock sold by Lydia to Agee and Nolan:

Year of purchase	1980
Year of sale	1988
Basis (cost)	$9,000
Sales price (equal to fair market value)	$4,000

The amount of long-term capital loss that Lydia realized in 1988 on the sale of this stock was:

A. $5,000

B. $3,000

C. $2,500

D. $0

Correct Answer: A

Choice "a" is correct. $5,000 long term capital loss "realized" in 1988 by Lydia. Be careful, and always check the question being asked. In this case, the question is how much of a capital loss Lydia realized in 1988.

Sales price (FMV)	$4,000
Basis (cost)	(9,000)
Loss realized	(5,000)

Choice "b" is incorrect. $3,000 represents the portion of the $5,000 realized loss that would currently be recognized unless there were additional capital transactions resulting in gains. Remember that the deduction for capital losses for an individual is limited to $3,000 each year. Choice "c" is incorrect. $2,500 represents the pre-1986 portion of the $5,000 realized loss that would have given rise to a recognized loss. Pre-1986 law required $2 of net long term loss to give the benefit of $1 of tax deduction. Current law gives a dollar-for-dollar deduction limited to $3,000 in any year. Choice "d" is incorrect. $0 would have been the amount of loss recognized if Lydia owned more than a 50% interest in the partnership. Losses realized on transactions between a partnership and a partner owning more than a 50% interest are not deductible as the parties would be considered related and any realized loss would be disallowed.