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QUESTION 1

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	<u>(1,200)</u>
Gain recognized	<u>\$1,300</u>

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 2

Farr made a gift of stock to her child, Pat. At the date of gift, Farr's stock basis was \$10,000 and the stock's fair market value was \$15,000. No gift taxes were paid. What is Pat's basis in the stock for computing gain?

- A. \$0
- B. \$5,000
- C. \$10,000
- D. \$15,000

Correct Answer: C

Choice "c" is correct. Property acquired as a gift generally retains the rollover cost basis as it had in the hands of the donor at the time of the gift. Basis is increased by any gift tax paid that is attributable to the net appreciation in the value of the gift. Since there were no gift taxes paid, Pat's basis for computing a gain is the rollover cost (basis), \$10,000. Choices "a", "b", and "d" are incorrect, per the explanation 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 self-employment tax. Payments not guaranteed are merely another way to distribute partnership profits. The ordinary income reported from an S corporation is taxable income to the individual on 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

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
	<u>115,000</u>	
Subtract - Cash collections	<u>(100,000)</u>	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 5

On December 31, 1989, a building owned by Pine Corp. was totally destroyed by fire. The building had fire insurance coverage up to \$500,000. Other pertinent information as of December 31, 1989 follows:

Building, carrying amount	\$520,000
Building, fair market value	550,000
Removal and clean-up cost	10,000

During January 1990, before the 1989 financial statements were issued, Pine received insurance proceeds of \$500,000. On what amount should Pine base the determination of its loss on involuntary conversion?

- A. \$520,000
- B. \$530,000
- C. \$550,000
- D. \$560,000

Correct Answer: B

Choice "b" is correct. \$530,000 basis of involuntary converted building.

Building carrying amount	\$520,000
Removal and clean up cost	<u>10,000</u>
Basis of involuntary conversion	\$530,000
Insurance proceeds	<u>(500,000)</u>
Loss on involuntary conversion	<u>\$ 30,000</u>

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