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QUESTION 1

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. $300

B. $750

C. $1,500 D. $2,000

Correct Answer: C

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 x $50 = $5,000. Calculate his gain as follows:

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

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

QUESTION 2

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. In 1994, Joan received $3,500 as beneficiary of the death benefit, which was provided by her brother\\'s employer. Joan\\'s brother did not have a nonforfeitable right to receive the money while living.

A. $0

B. $500

C. $900

D. $1,000

E. $1,250

F. $1,300

G. $1,500

H. $2,000

I. $2,500

J. $3,000

K. $10,000

L. $25,000

M. $50,000

N. $55,000

O. $75,000

Correct Answer: A

"A" is correct. $0. Life insurance proceeds received by reason of the death of the insured are not taxable income to the recipient.

QUESTION 3

Ryan, age 57, is single with no dependents. On July 1, 1997, Ryan\\'s principal residence was sold for the net amount of $500,000 after all selling expenses. Ryan bought the house in 1963 and occupied it until sold. On the date of sale, the house had a basis of $180,000. Ryan does not intend to buy another residence. What is the maximum exclusion of gain on sale of the residence that may be claimed in Ryan\\'s 1997 income tax return?

A. $320,000

B. $250,000

C. $125,000

D. $0

Correct Answer: B

Choice "b" is correct. $250,000 maximum exclusion from taxable income.

Rule: An individual may exclude from income up to $250,000 gain provided that the property was the

taxpayer\\'s primary residence for 2 of the last 5 years. Married taxpayers may exclude gains up to

$500,000.

Choice "a" is incorrect. $320,000. Ryan, age 57, was not married. Thus, his exclusion was limited to

$250,000.

Choice "c" is incorrect. The $125,000 exclusion was old law and eliminated for sales after 5/6/97.

Choice "d" is incorrect, per the above rule.

QUESTION 4

Which one of the following statements is correct with regard to an individual taxpayer who has elected to amortize the premium on a bond that yields taxable interest?

A. The amortization is treated as an itemized deduction.

B. The amortization is not treated as a reduction of taxable income.

C. The bond\\'s basis is reduced by the amortization.

D. The bond\\'s basis is increased by the amortization.

Correct Answer: C

Choice "c" is correct. The bond\\'s basis is reduced by the amortization of the premium.

Choice "a" is incorrect. For bonds acquired after 12/31/87, the amortization of the premium is an offset to

interest income on the bond rather than a separate interest deduction.

Choice "b" is incorrect. The amortization of the premium will reduce taxable income.

Choice "d" is incorrect. The bond\\'s basis will be decreased by the amortization.

QUESTION 5

For a cash basis taxpayer, gain or loss on a year-end sale of listed stock arises on the:

A. Trade date.

B. Settlement date.

C. Date of receipt of cash proceeds.

D. Date of delivery of stock certificate.

Correct Answer: A

Choice "a" is correct. Trade date.

Gain or loss on a year-end sale of listed stock arises on the trade date.

Rule: Whether on the cash or accrual method of accounting taxpayers who sell stock or securities on an

established securities market must recognize gains and losses on the trade date, rather than on the

settlement date.

Choices "b", "c", and "d" are incorrect, per the above rule.