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CPA Regulation

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QUESTION 1

Cobb, an unmarried individual, had an adjusted gross income of \$200,000 in 1990 before any IRA deduction, taxable social security benefits, or passive activity losses. Cobb incurred a loss of \$30,000 in 1990 from rental real estate in which he actively participated. What amount of loss attributable to this rental real estate can be used in 1990 as an offset against income from nonpassive sources?

- A. \$0
- B. \$12,500
- C. \$25,000
- D. \$30,000

Correct Answer: A

Choice "a" is correct. Cobb may not use any of the loss attributable to his rental real estate as an offset against income from nonpassive sources in 1990 because he does not qualify for the "Mom and Pop" exception. Under this exception, up to \$25,000 of passive losses and the deduction equivalent of tax credits that are attributable to rental real estate may be used as an offset against income from nonpassive sources. This \$25,000 allowance is reduced, but not below zero, by 50% of the amount by which the individual's modified AGI exceeds \$100,000. The \$25,000 is therefore completely phased out when modified AGI reaches \$150,000. Because Cobb's AGI was \$200,000, he did not qualify for the exception. Choices "b", "c", and "d" are incorrect. Rental activities are passive activities and generally are not allowed to use any of the loss attributable to the rental activity to offset any income produced from nonpassive sources. There is a limited exception in the case of losses from rental real estate in which the taxpayer actively participates, but Cobb did not qualify for it.

QUESTION 2

Which one of the following will result in an accruable expense for an accrual-basis taxpayer?

- A. An invoice dated prior to year end but the repair completed after year end.
- B. A repair completed prior to year end but not invoiced.
- C. A repair completed prior to year end and paid upon completion.
- D. A signed contract for repair work to be done and the work is to be completed at a later date.

Correct Answer: B

RULE: An accruable expense is one in which the services have been received/performed but have not been paid for by the end of the reporting period.

Choice "b" is correct. The facts indicate that a repair was completed prior to year end but not yet invoiced. If it has not yet been invoiced, it is assumed that it has also not yet been paid for. Therefore, this is a situation in which the repair expense would be accrued at year end. Services have been performed, but they have not been paid for, as they have not even been invoiced yet. Choice "a" is incorrect. If the repair was completed after year end, then the expense is not accruable, as the benefit of the services hasn't been received as of year end. The fact that the repair was invoiced prior to year end does not impact the situation. Choice "c" is incorrect. If a repair was completed and paid for prior to year end, no accrual is appropriate. On the accrual basis, the expense is taken in the year the repair is completed and the benefit is received. In this case, the account payable was also paid in the same year, but this has no effect on the

expense. Choice "d" is incorrect. The facts indicate that the work is to be completed at a date later than year end. Therefore, the expense is not accruable at year end, as the benefit of the repair hasn't been received as of year end. It is reasonable that a signed contract for the repair work exists, but this has no effect on the accrual.

QUESTION 3

Starr, a self-employed individual, purchased a piece of equipment for use in Starr's business. The costs associated with the acquisition of the equipment were:

Purchase price	\$55,000
Delivery charges	725
Installation fees	300
Sales tax	3,400

What is the depreciable basis of the equipment?

- A. \$55,000
- B. \$58,400
- C. \$59,125
- D. \$59,425

Correct Answer: D

Choice "d" is correct. The rules for depreciable basis in tax are generally the same as the GAAP rules for capitalizing an asset. The depreciable basis is the cost associated with the purchase of the asset and with getting the asset ready for its intended use. Further improvements are also capitalized, and the basis is reduced for any accumulated depreciation. In this case, the cost of obtaining the equipment and getting the equipment ready for its intended use includes all the items shown above, as follows: Choice "a" is incorrect. The costs of delivery charges, installation, and sales tax are all part of the cost of obtaining the asset and getting the asset ready for its intended use. All of these charges are included in the depreciable basis of the equipment. Choice "b" is incorrect. The costs of delivery charges and installation are both part of the cost of obtaining the asset and getting the asset ready for its intended use. These charges are included in the depreciable basis of the equipment. Choice "c" is incorrect. The cost of installation is part of the cost getting the asset ready for its intended use. This charge is included in the depreciable basis of the equipment.

Purchase price	\$55,000
Delivery charges	725
Installation fees	300
Sales tax	<u>3,400</u>
Total depreciable basis	<u>\$59,425</u>

QUESTION 4

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 5

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. Tom received \$10,000, consisting of \$5,000 each of principal and interest, when he redeemed a Series EE savings bond in 1994. The bond was issued in his name in 1990 and the proceeds were used to pay for Laura's college tuition. Tom had not elected to report the yearly increases in the value of the bond.

- 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. Generally, if a taxpayer does not make an election to accrue interest income from Series EE bonds, the interest is taxable at the time the bonds are cashed. However, an exception applies in this case because Tom Moore meets the criteria (assume he was 24 years or older in 1990). Savings bonds is tax-exempt when:

(1)

It is used to pay for qualified higher-education expenses for the taxpayer, spouse, or dependents;

(2)

There is taxpayer or joint ownership with spouse;

(3)

The taxpayer is age 24 (or over) when the bonds are issued; and

(4)

The bonds are acquired after 1989.

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