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QUESTION 1

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 2

Leker exchanged a van that was used exclusively for business and had an adjusted tax basis of \$20,000 for a new van. The new van had a fair market value of \$10,000, and Leker also received \$3,000 in cash. What was Leker's tax basis in the acquired van?

- A. \$20,000
- B. \$17,000
- C. \$13,000
- D. \$7,000

Correct Answer: B

Choice "b" is correct. \$17,000 is the tax basis in the van. The basis for like-kind exchanges is computed as follows: The general rule is the gain is recognized to the extent boot is received. As the transaction results in a loss to Leker (he received an asset worth \$10,000 plus \$3,000 cash less a \$20,000 tax basis equals \$7,000 loss) no gain is recognized and the \$3,000 received reduces his basis in the new asset. Choice "a" is incorrect. Basis must be reduced by non-like-kind assets (boot) received. Choice "c" is incorrect. For non-like-kind exchanges, the basis would be the FMV of the assets received (\$10,000 FMV plus \$3,000 Boot). However, because both assets have similar use, this is a like-kind exchange, which follows the rule above. Choice "d" is incorrect. The basis of the old property is used to calculate the basis of the new property, less any boot received.



Basis of old property
Less: Boot received
New basis

\$20,000
(3,000)
\$17,000

QUESTION 3

Conner purchased 300 shares of Zinco stock for \$30,000 in 1980. On May 23, 1994, Conner sold all the stock to his daughter Alice for \$20,000, its then fair market value. Conner realized no other gain or loss during 1994. On July 26, 1994, Alice sold the 300 shares of Zinco for \$25,000.

What amount of the loss from the sale of Zinco stock can Conner deduct in 1994?

- A. \$0
- B. \$3,000
- C. \$5,000
- D. \$10,000

Correct Answer: A

Choice "a" is correct. Even though Conner has a realized loss of \$10,000 on this transaction he cannot deduct the loss since it was incurred in a transaction with his daughter, a related party. Choice "b" is incorrect. \$3,000 is the limit on deductible net capital losses. However, Conner cannot deduct this loss, since it was incurred in a transaction with his daughter, a related party. Choice "c" is incorrect. Conner's realized loss on the sale is \$10,000 (\$20,000 proceeds less \$30,000 basis). However, Conner cannot deduct this loss, since it was incurred in a transaction with his daughter, a related party. Choice "d" is incorrect. \$10,000 is Conner's realized loss on the sale. However, Conner cannot deduct this loss, since it was incurred in a transaction with his daughter, a related party.

QUESTION 4

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

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

A. Option A



B. Option B

C. Option C

D. Option D

Correct Answer: A

Choice "a" is correct. Direct material, direct labor, and factory overhead (applicable indirect costs) are capitalized with respect to inventory under the uniform capitalization rules for property acquired for resale.

Applicable indirect costs include depreciation and amortization, insurance, supervisory wages, utilities, spoilage and scrap, design expenses, repair and maintenance and rental of equipment and facilities (including offsite storage), some administrative costs, costs of bonus and other incentive plans, and indirect supplies and other materials (including repackaging costs).

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

QUESTION 5

In a tax year where the taxpayer pays qualified education expenses, interest income on the redemption of qualified U.S. Series EE Bonds may be excluded from gross income. The exclusion is subject to a modified gross income limitation and a limit of aggregate bond proceeds in excess of qualified higher education expenses. Which of the following is (are) true?

I. The exclusion applies for education expenses incurred by the taxpayer, the taxpayer's spouse, or any person whom the taxpayer may claim as a dependent for the year.

II. "Otherwise qualified higher education expenses" must be reduced by qualified scholarships not includible in gross income.

A. I only.

B. II only.

C. Both I and II.

D. Neither I nor II.

Correct Answer: C

Choice "c" is correct. Interest earned on Series EE bonds issued after 1989 may qualify for exclusion. One requirement is that the interest is used to pay tuition and fees for the taxpayer, spouse, or dependent enrolled in higher education. The interest exclusion is reduced by qualified scholarships that are exempt from tax and other nontaxable payments received for educational expenses (other than gifts and inheritances).