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QUESTION 1

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 was Alice\\'s recognized gain or loss on her sale?

A. $0

B. $5,000 long-term gain.

C. $5,000 short-term loss.

D. $5,000 long-term loss.

Correct Answer: A

Choice "a" is correct. Alice has a realized gain of $5,000 on the transaction: $25,000 sales price less $20,000 purchase price. However, she can reduce the gain, but not below zero, by the amount of loss her father could not deduct on the sale to her. Thus, Alice can reduce her gain by up to $10,000, but not below zero. Here, the gain is $5,000, so it is reduced to zero. Conner should have sold the stock in the open market so that he could deduct the entire loss. Alice could then have purchased the stock in the open market. Choice "b" is incorrect. $5,000 is Alice\\'s realized long-term gain on the sale. However, she can reduce the gain, but not below zero, by the amount of loss her father could not deduct on the sale to her. Choice "c" is incorrect. Alice has a realized gain of $5,000 on the sale. However, since she is related to Conner, her holding period includes his holding period. Therefore, her realized gain is long-term. In addition, she can reduce the gain, but not below zero, by the amount of loss her father could not deduct on the sale to her. Choice "d" is incorrect. Alice can reduce the gain by the amount of loss her father could not deduct on the sale to her. However, she cannot reduce the gain below zero.

QUESTION 2

Smith, an individual calendar-year taxpayer, purchased 100 shares of Core Co. common stock for $15,000 on December 15, 1992, and an additional 100 shares for $13,000 on December 30, 1992. On January 3, 1993, Smith sold the shares purchased on December 15, 1992, for $13,000. What amount of loss from the sale of Core\\'s stock is deductible on Smith\\'s 1992 and 1993 income tax returns?

	1992	1993
A.	$0	$0
B.	$0	$2,000
C.	$1,000	$1,000
D.	$2,000	$0

A. Option A

B. Option B

C. Option C

D. Option D

Correct Answer: A

Choice "a" is correct. In 1992, no sale of stock occurred so there would be no loss. In 1993, there is a $2,000 loss realized ($15,000 basis less $13,000 received), but it is not deductible because it is a wash sale. A wash sale occurs when a taxpayer sells stock at a loss and invests in substantially identical stock within 30 days before or after the sale. In this case, Smith reinvested in an additional 100 shares four days prior to selling 100 shares of the same stock at a loss. The $2,000 disallowed loss would, however, increase the basis of the new shares by $2,000.

Choice "b" is incorrect. The $2,000 loss realized in 1993 is disallowed under the wash sale rules.

Choice "c" is incorrect. In 1992, there is no loss since no shares were sold. In 1993, the $2,000 loss is

disallowed under the wash sale rules.

Choice "d" is incorrect. In 1992, there is no possible loss since no shares were sold.

QUESTION 3

Don Wolf became a general partner in Gata Associates on January 1, 1989, with a 5% interest in Gata\\'s profits, losses, and capital. Gata is a distributor of auto parts. Wolf does not materially participate in the partnership business. For the year ended December 31, 1989, Gata had an operating loss of $100,000. In addition, Gata earned interest of $20,000 on a temporary investment. Gata has kept the principal temporarily invested while awaiting delivery of equipment that is presently on order. The principal will be used to pay for this equipment. Wolf\\'s passive loss for 1989 is:

A. $0

B. $4,000

C. $5,000

D. $6,000

Correct Answer: C

Choice "c" is correct. Wolf\\'s passive loss for 1989 is $5,000 ($100,000 operating loss ?5% interest in

partnership).

Choice "a" is incorrect. Wolf did not materially participate in the partnership, so the loss was passive.

Choice "b" is incorrect. Wolf\\'s passive loss of $5,000 could not be reduced by his distributive share of the

partnership\\'s "interest income" totaling $1,000. Interest income is considered "portfolio income," and

neither the partnership nor a partner can offset it against passive losses.

Choice "d" is incorrect. No items of income or deduction from portfolio income or activities in which the

taxpayer materially participates may be combined or offset with passive losses unless the activity generating the loss is completely disposed of in a taxable transaction.

QUESTION 4

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 $1,300 in unemployment compensation benefits. Her employer made a $100 contribution to the unemployment insurance fund on her behalf.

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: F

"F" is correct. $1,300. Unemployment compensation benefits are fully taxable (when received by the employee), but contributions made by the employer to the insurance fund are not taxable.

QUESTION 5

Greller owns 100 shares of Arden Corp., a publicly-traded company, which Greller purchased on January 1, 2001, for $10,000. On January 1, 2003, Arden 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 Arden stock was $62 per share. On February 1, 2003, Greller had his broker specifically sell the 100 shares of Arden stock received in the split when the FMV of the stock was $65 per share. What is the basis of the 100 shares of Arden sold?

A. $5,000

B. $6,000

C. $6,200

D. $6,500

Correct Answer: A

Choice "a" is correct. The receipt of a nontaxable stock dividend will require the shareholder to spread the basis of his original share 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, Greller 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 100 share is 100 x $50 = $5,000.

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