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QUESTION 1

Which of the following is subject to the Uniform Capitalization Rules of Code Sec. 263A?

- A. Editorial costs incurred by a freelance writer.
- B. Research and experimental expenditures.
- C. Mine development and exploration costs.
- D. Warehousing costs incurred by a manufacturing company with \$12 million in annual gross receipts.

Correct Answer: D

Choice "d" is correct. Uniform capitalization rules apply to the following: (1) real or tangible personal property produced by the taxpayer for use in his or her trade or business; (2) real or tangible personal property produced by the taxpayer for sale to his or her customers; and (3) real or tangible personal property acquired by the taxpayer for resale, provided the taxpayer's annual average gross receipts for the preceding three years exceeds \$10,000,000. Warehousing costs incurred by a manufacturing company (making inventory for sale to its customers) are subject to the Uniform Capitalization Rules. Further, they are the only item on the list that is real or tangible personal property. In this case, the inventory is not acquired for resale (it is produced by the taxpayer for sale to his or her customers), so the fact that the annual sales are \$12,000,000 does not matter in this case. The sales could have been less than \$10,000,000 annually, and the Uniform Capitalization Rules would still have applied. Choices "a", "b", and "c" are incorrect, based on the above discussion.

QUESTION 2

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>

QUESTION 3

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. The Moores received a \$500 security deposit on their rental property in 1994. They are required to return the amount to the tenant.

- 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. The security deposit is not taxable income because the Moores are required to return it when the tenant leaves. If the deposit is applied to damages in a later tax year, the portion the Moores retain would be income to them in the year they retain the deposit, and the money they spend to repair the damage would be a deduction to them.



QUESTION 4

Among which of the following related parties are losses from sales and exchanges not recognized for tax purposes?

- A. Father-in-law and son-in-law.
- B. Brother-in-law and sister-in-law.
- C. Grandfather and granddaughter.
- D. Ancestors, lineal descendants, and all in-laws.

Correct Answer: C

Choice "c" is correct. Losses from sales and exchanges are not recognized for tax purposes between grandfather and granddaughter. Rule: Losses are disallowed on sales between related parties. "Related" includes brothers and sisters, husband-wife, lineal descendants (father, son, grandfather), and entities that are more than 50% owned by individuals, corporations, trusts and/or partnerships.

Choices "a", "b", and "d" are incorrect, because losses from sales and exchanges are recognized for all "in-laws."

QUESTION 5

In the current year Jensen had the following items:

Salary	\$50,000
Inheritance	25,000
Alimony from ex-spouse	12,000
Child support from ex-spouse	9,000
Capital loss on investment stock sale	(6,000)

What is Jensen's AGI for the current year?

- A. \$44,000
- B. \$59,000
- C. \$62,000
- D. \$84,000

Correct Answer: B

Choice "b" is correct. The question asks for AGI, but all of the items in the list are items of potential gross income. There



are no adjustments included in the list; therefore, in this case, AGI is the same as gross income. The calculation is as follows:

Salary	\$50,000
Inheritance	0 [not taxable]
Alimony from ex-spouse	12,000
Child support from ex-spouse	0 [not taxable]
Capital loss on investment stock sale	(3,000) [maximum deductible]
AGI	<u>\$59,000</u>

Choices "a", "c", and "d" are incorrect, per the above calculation.

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