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QUESTION 1

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 2

Gibson purchased stock with a fair market value of \$14,000 from Gibson's adult child for \$12,000. The child's cost basis in the stock at the date of sale was \$16,000. Gibson sold the same stock to an unrelated party for \$18,000. What is Gibson's recognized gain from the sale?

- A. \$0
- B. \$2,000



C. \$4,000

D. \$6,000

Correct Answer: B

Choice "b" is correct. Losses are disallowed on most related party sales transactions even if they were made at an arm's length (FMV) price. The basis (and related gain or loss) of the (second) buying relative depends on whether the second relative's resale price is higher, lower, or between the first relative's basis and the lower selling price to the second relative. In this case, the \$4,000 capital loss on the sale by Gibson's adult child to Gibson [\$12,000 SP - \$16,000 Basis] is disallowed. Gibson's basis is determined by his selling price to a third party. In this case, the selling price is \$18,000, which is HIGHER than the original basis of Gibson's adult child. Gibson's basis in the stock is, therefore, his adult child's basis of \$16,000.

Gibson's recognized basis is calculated as follows:

Selling price	\$18,000
Basis	<u>(16,000)</u>
Gain	<u>\$ 2,000</u>

Choice "a" is incorrect. There would be a zero gain or loss if the selling price were between the adult child's basis and Gibson's purchase price, but this is not the case in the facts. Choice "c" is incorrect. This answer option uses the fair market value of the stock at the date of purchase as the basis. As is discussed above, the rules do not provide for this treatment. [\$18,000 SP - \$14,000 FMV = \$4,000] Choice "d" is incorrect. This would be the answer if the basis were Gibson's purchase price of \$12,000; however, because the stock sold for more than Gibson's child's basis and the child had a disallowed loss on the sale to Gibson, Gibson is allowed to use his child's original basis of \$16,000 as his basis for the stock on the date of the second sale. [\$18,000 SP - \$12,000 PP = \$6,000]

QUESTION 3

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 4

Freeman, a single individual, reported the following income in the current year:

Guaranteed payment from services rendered to a partnership \$50,000 Ordinary income from a S corporation \$20,000

What amount of Freeman's income is subject to self-employment tax?

- A. \$0
- B. \$20,000
- C. \$50,000
- D. \$70,000

Correct Answer: C

Choice "c" is correct. Guaranteed payments are reasonable compensation paid to a partner for services rendered (or use of capital) without regard to his ratio of income. Earned compensation is subject to selfemployment tax. Payments not guaranteed are merely another way to distribute partnership profits. The ordinary income reported from an S corporation are taxable income to the individual or their own individual tax return but is not subject to self-employment tax. The ordinary income reported from a partnership may be subject to self-employment tax (if to a general partner).

QUESTION 5

Porter was unemployed for part of the year. Porter received \$35,000 of wages, \$4,000 from a state unemployment compensation plan, and \$2,000 from his former employer's company-paid supplemental unemployment benefit plan. What is the amount of Porter's gross income?

- A. \$35,000
- B. \$37,000
- C. \$39,000
- D. \$41,000

Correct Answer: D

RULE: Gross income includes all income unless it is specifically excluded in the tax code.

Choice "d" is correct. Wages and all unemployment compensation are not excluded from being taxable;

therefore, there are included in the taxpayer's gross income for tax purposes.



Wages received	\$35,000
State unemployment compensation	4,000
Employer's unemployment compensation plan	<u>2,000</u>
	<u>\$41,000</u>

Choice "a" is incorrect. All forms of unemployment compensation are included as part of gross income. Choice "b" is incorrect. The \$4,000 of state unemployment compensation received is included as part of gross income. Choice "c" is incorrect. The \$2,000 of his former employer's company-paid supplemental unemployment benefit plan is included as part of gross income.

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