|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 1. Connie was walking her dog when she came across a paper bag with $20,000 in it. She turned over the money to the police. After the appropriate period of time, no one claimed the money and the police returned the money to Connie. Connie does not have to recognize any taxable income since it was not derived from capital or labor.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | False |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 2. According to the U.S. Supreme Court, income may be defined as the gain derived from capital, from labor, or from both combined, provided it is understood to include profit gained through sale or conversion of capital assets.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | True |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 3. Rachael purchased 300 shares of Smelt, Inc. stock for $25 per share. At the end of the year, the stock price has risen to $30 per share. Rachael does not recognize taxable income even though there has been a $1,500 increase in wealth.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | True |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 4. Julian is operating an illegal gambling operation. Even though the income is not legal, it is classified as earned.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | True |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 5. Ruth purchased an annuity contract for $10,000. When she turns 65, she will receive $150 a month for the rest of her life. The first $10,000 that she receives is a return of her capital and is not taxable.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | False |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 6. For any unrecovered portion of an annuity investment, the taxpayer is allowed a deduction in the year of death.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | True |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 7. Ron won a $25,000 award for his research in microbiology, and he immediately transferred the prize to his brother who does similar research. The income is excluded from Ron's taxable income.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | False |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 8. Brandon and Judy divorce during the year and agree that Brandon will pay Judy $24,000 a year in alimony. Brandon will be able to reduce his income by $24,000, but Judy does not have to report any income since it was not earned.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | False |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 9. Terry owns 100% of Terry Manufacturing, Inc. and has the corporation pay his son's college tuition. Terry must include the payments in his taxable income.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | True |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 10. The holding period for receiving long-term capital gain treatment is more than 12 months.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | True |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 11. Net collectibles gains are taxed at a maximum rate of 25 percent.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | False |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 12. Mercedes has a net long-term capital gain of $3,000 and a net short-term capital loss of $10,000. She can deduct $3,000 of the $7,000 net loss as a deduction for adjusted gross income in the current year. She must defer realizing any tax benefit from the remaining $4,000 loss to the next year.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | True |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 13. An accrual basis taxpayer does not have income until there is an actual or constructive receipt of income earned.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | False |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 14. Friendly Finance loans Anne $10,000, and she will pay $13,130 at the end of 3 years. Since Friendly is on a cash basis, it will recognize the $3,130 interest income when the loan is repaid.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | False |

 |

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 15. The hybrid method of accounting provides that taxpayers will account for sales of merchandise and the related cost of goods sold on the accrual basis and all other items of income and expense on the cash basis.

|  |  |  |
| --- | --- | --- |
|   | a.  | True |
|   | b.  | False |

|  |  |
| --- | --- |
| *ANSWER:* | True |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 16. Income realization may occur as a result of:

|  |  |
| --- | --- |
| I. | relief from a liability. |
| II. | exchange of property. |
| III. | payment of the taxpayer's indebtedness by another. |
| IV. | a barter transaction where only goods and services are exchanged. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Statements I and IV are correct. |
|   | d.  | Statements I, II, and IV are correct. |
|   | e.  | Statements I, II, III, and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 17. Which of the following constitutes a realization?

|  |  |
| --- | --- |
| I. | Jamie prepares a will for Wilson. He pays her by painting her house. |
| II. | Jone's cow gives birth. The calf will become a member of Jone's feeder cattle herd. |
| III. | Oak Ridge Coal Company's coal mine reserves are appraised at $5,750,000 more than the previous year's appraisal. |
| IV. | Lea's employer gives her (and all other salaried employees) a weekend in Orlando in recognition of their efforts to make this a successful year. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Statements I and II are correct. |
|   | d.  | Statements I and IV are correct. |
|   | e.  | Statements II, III, and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 18. Which of the following constitutes a realization?

|  |  |
| --- | --- |
| I. | Frank's lakeside cottage is damaged in a violent storm. The cost of repairs totaled $4,000. However, the insurance company gives Frank only $2,500 for the repairs. |
| II. | McDonald's cow gives birth. The calf will become a member of McDonald's feeder cattle herd. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 19. Which of the following constitutes a realization?

|  |  |
| --- | --- |
| I. | Oak Ridge Coal Company's coal mine reserves are appraised at $5,750,000 more than the previous year's appraisal. |
| II. | Lea's employer gives her (and all other salaried employees) a weekend in Chicago in recognition of their efforts to make this a successful year. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 20. Carlotta finds a chest inscribed "Sinbad" that contains $250,000 of cash while diving among the coral reefs off the Virgin Islands. The U.S. Customs and the DEA deny knowledge of the cash, so Carlotta keeps it.

|  |  |
| --- | --- |
| I. | Carlotta would not recognize any gross income if the chest contained jewels valued at $250,000 rather than the cash at the time of discovery. |
| II. | Recognition is necessary because Carlotta has an increase in wealth. |
| III. | Recognition will not occur because the windfall would not be considered as derived from capital or labor. |
| IV. | The all-inclusive Income Concept explains the recognition of income from whatever source derived. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Statements I and IV are correct. |
|   | d.  | Statements I, II, and IV are correct. |
|   | e.  | Statements II, III, and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 21. Marta finds a chest inscribed "Jack Sparrow" that contains $750,000 of cash while diving among the coral reefs off Key West, Florida. The U.S. Customs and the DEA denied knowledge of the cash, so Marta keeps it.

|  |  |
| --- | --- |
| I. | Recognition will not occur because the windfall would not be considered as derived from capital or labor. |
| II. | The all-inclusive Income Concept explains the recognition of income from whatever source derived. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 22. Sophi finds a chest inscribed "Captain Hook" that contains $500,000 of cash while fishing off the shore around New Orleans. The U.S. Customs and the DEA denied knowledge of the cash, so Sophi keeps it.

|  |  |
| --- | --- |
| I. | Sophi will not recognize any gross income if the chest contained jewels valued at $500,000 rather than cash at the time of discovery. |
| II. | Recognition is necessary because this is a treasure trove and it is comprised of cash. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 23. Ellie, age 12, earns wages of $4,300 from modeling. Since the fees are collected by Ellie's father and used for Ellie's living expenses, her father intends to include it in his gross income.

|  |  |
| --- | --- |
| I. | Ellie received no cash, so she does not have to report any income. |
| II. | The assignment of income doctrine prohibits the father from recognizing the $4,300. |
| III. | Even if Ellie desired to gift the $4,300 to her father, Ellie must recognize the income she earned. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Only statement III is correct. |
|   | d.  | Statements II and III are correct. |
|   | e.  | Statements I, II, and III are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 24. Meredith, age 14, earns wages of $2,100 from modeling. Since the funds are collected by Meredith's father and used for some of Meredith's living expenses, her father intends to include it in his gross income.

|  |  |
| --- | --- |
| I. | The person that earns the income will recognize it, Meredith in this case. |
| II. | The assignment of income doctrine prohibits the father from recognizing the $2,100. |

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 25. Hilda, age 11, earns wages of $2,700 from modeling. Since the funds are collected by Hilda's father and used for Hilda's living expenses, her father intends to include it in his gross income.

|  |  |
| --- | --- |
| I. | The assignment of income doctrine prohibits the father from recognizing the $2,700. |
| II. | Even if Hilda desired to gift the $2,700 to her father, Hilda must recognize the income she earned. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 26. Ramsey Corporation allows Corrine, an employee, to use a company car for her vacation to San Diego.

|  |  |
| --- | --- |
| I. | Corrine will not need to recognize the value of the use of the car since it was not cash. |
| II. | A cash-equivalent approach is used to measure the amount of income that must be recognized by Corrine. |
| III. | The employer–employee relationship indicates that providing the car is a type of compensation for services rendered. |
| IV. | Income recognition is not necessary in this case. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement IV is correct. |
|   | c.  | Statements II and III are correct. |
|   | d.  | Statements I and IV are correct. |
|   | e.  | Statements II, III, and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 27. Alexis Corporation allows Cynthia, an employee, to use a company car for her vacation to San Diego.

|  |  |
| --- | --- |
| I. | Cynthia will not need to recognize the value of the use of the car since it was not cash. |
| II. | A cash-equivalent approach is used to measure the amount of income that must be recognized by Cynthia. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 28. National Corporation allows Phyllis, an employee, to use a company car for her vacation to San Diego.

|  |  |
| --- | --- |
| I. | The employer–employee relationship indicates that providing the car is a type of compensation for services rendered. |
| II. | Income recognition is not necessary in this case. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 29. James bought an annuity for $42,000 several years ago. The annuity will pay him $250 per month from age 66 until he dies. During the current year, James turned 66 and received his first annuity payment. His life expectancy is 25 years.

|  |  |
| --- | --- |
| I. | If James receives more than 260 payments, all payments received after those are totally included in his income. |
| II. | James should include $50 of each payment in his adjusted gross income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 30. Charles bought an annuity for $30,000 several years ago. The annuity will pay him $250 per month from age 62 until he dies. During the current year, Charles turns 62 and receives his first annuity payment.

|  |  |
| --- | --- |
| I. | If Charles dies after receiving 192 monthly payments, he must amend prior returns and correct the income reported based on 192 monthly payments. |
| II. | If Charles receives more than 260 payments, the total of each payment received after the 260th payment is included in his income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 31. Penny, age 45, purchased an annuity contract that cost $45,000. The contract will pay Penny $600 per month for 10 years after she reaches age 62. During the current year, Penny turns 62 and receives 4 payments under the contract. Penny's taxable income from the annuity payments is:

|  |  |  |
| --- | --- | --- |
|   | a.  | $900. |
|   | b.  | $1,500. |
|   | c.  | $1,708. |
|   | d.  | $2,250. |
|   | e.  | $2,400. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 32. Penelope purchased an annuity contract that cost $45,000. The contract will pay Penelope $600 per month for 10 years after she reaches the age of 62. During the current year, Penelope turns 62 and receives 4 payments under the contract. The amount Penelope may exclude from taxable income as a return of capital on this year's payments is:

|  |  |  |
| --- | --- | --- |
|   | a.  | $692. |
|   | b.  | $900. |
|   | c.  | $1,500. |
|   | d.  | $2,250. |
|   | e.  | $2,400. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 33. The income tax treatment of payments from annuity contracts is based on the:

|  |  |
| --- | --- |
| I. | capital recovery concept. |
| II. | assignment of income doctrine. |
| III. | annual accounting period concept. |
| IV. | arm's-length transaction concept. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement IV is correct. |
|   | c.  | Statements II and III are correct. |
|   | d.  | Statements I and IV are correct. |
|   | e.  | Statements I and III are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 34. Ursula owns an annuity that pays her $850 per month until she dies. Which of the following income tax concepts provides for the tax treatment of the annuity payments that Ursula receives (and the treatment in the year of death)?

|  |  |
| --- | --- |
| I. | The administrative convenience concept |
| II. | The annual accounting period concept |
| III. | The capital recovery concept |
| IV. | The constructive receipt doctrine |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Statements I and II are correct. |
|   | b.  | Statements II and III are correct. |
|   | c.  | Statements I and IV are correct. |
|   | d.  | Only statement IV is correct. |
|   | e.  | Only statement II is correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 35. Lidia, age 62, will retire this year from her job as executive vice president of Western Inc. She will receive a pension of $3,000 per month from Rollerderby's qualified pension plan. Lidia contributed $100,000 to the plan. Her contributions were never subject to tax. In addition, she will receive $1,600 per month from an annuity she purchased many years ago at a cost of $96,000. The pension and the annuity will be paid until she dies. On the day of her retirement, her life expectancy is 30 years. Which of the following statements regarding the taxability of the payments is/are correct?

|  |  |
| --- | --- |
| I. | Under the capital recovery concept, Lidia will not have to recognize any income from the annuity payment until she has recovered her $96,000 investment. |
| II. | Lidia will not have to recognize as income the portion of each pension plan payment that is considered a return of her $100,000 contribution to the plan. |
| III. | Lidia will not have to recognize as income the portion of each annuity payment that is a return of her $96,000 investment. |
| IV. | Because none of the contributions were taxed, Lidia will be taxed on the entire $3,000 from the pension plan. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Statements II and III are correct. |
|   | c.  | Only statement III is correct. |
|   | d.  | Statements III and IV are correct. |
|   | e.  | Only statement IV is correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 36. Martin purchased an annuity contract at the beginning of 2002 for $84,000. The contract specifies that he will receive $2,000 per month for life. Martin receives his first payments on July 1, 2014, when he was 67 years old. Martin dies on August 15, 2019 (the August payment was received prior to his death). What amount, if any, should be deducted on Martin's 2019 tax return as a result of failing to receive his expected return on the annuity contract?

|  |  |  |
| --- | --- | --- |
|   | a.  | $54,400 can be claimed as a deduction on his final return. |
|   | b.  | $59,200 can be claimed as a deduction on his final return. |
|   | c.  | $1,600 can be claimed as a deduction on his final return. |
|   | d.  | No deduction is reported because a decedent is not required to file a final return. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 37. Leroy purchased an annuity from an insurance company for $42,000. He has been receiving $940 monthly from the annuity. Leroy began receiving the payments when he was 72 years old, and he has now received annuity payments for 13.33 years. How much of each subsequent $940 payment must Leroy include in his gross income?

|  |  |
| --- | --- |
| I. | The capital recovery concept explains the result. |
| II. | Leroy may exclude 100% of the annuity payments received. |
| III. | Leroy must recognize 100% of the annuity payments received. |
| IV. | Leroy will continue to recognize the same amount that he recognized in all prior years. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement III is correct. |
|   | c.  | Only statement IV is correct. |
|   | d.  | Statements I and III are correct. |
|   | e.  | Statements I and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 38. Jerry purchased an annuity contract at the beginning of 2004 for $144,000. The contract specified that he and his wife would receive $1,000 per month for life. Jerry receives his first payment on February 1, 2019, when he is 59 years old and his wife is 56 years old. What amount of gross income should Jerry and his wife report on their 2019 income tax return from this annuity contract?

|  |  |  |
| --- | --- | --- |
|   | a.  | $-0- |
|   | b.  | $4,400 |
|   | c.  | $6,600 |
|   | d.  | $11,000 |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 39. Jennifer owns 60% of the stock in Heath Corporation. During the current year, Heath Corporation has a taxable income of $80,000 and pays dividends of $30,000. Which of the following statements about Jennifer's income from Heath Corporation is/are correct?

|  |  |
| --- | --- |
| I. | If Heath Corporation is an S corporation, Jennifer must recognize $48,000 of income. |
| II. | If Heath Corporation is a corporation, Jennifer must recognize $18,000 of income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 40. Roberta invests $16,000 for a 10% interest in Bowie Partnership. In the first year of operations, Bowie reports a net income of $80,000 from operations and distributes $6,000 cash to Roberta. How much gross income must Roberta recognize from her investment in Bowie?

|  |  |  |
| --- | --- | --- |
|   | a.  | $2,000 |
|   | b.  | $6,000 |
|   | c.  | $8,000 |
|   | d.  | $80,000 |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 41. Darnel owns 10% of the stock in Allison Company. During the current year, Allison has an operating income of $200,000 and distributes $80,000 to its owners.

|  |  |
| --- | --- |
| I. | If Allison is a corporation, Darnel has $8,000 of income from Allison. |
| II. | If Allison is a partnership, Darnel has $20,000 of income from Allison. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 42. Which of the following statements concerning prizes and awards is/are correct?

|  |  |
| --- | --- |
| I. | All prizes and awards are exempt from taxation. |
| II. | Employee awards of tangible personal property for length of service are partially excludable. |
| III. | Any prize or award received can be excluded if it is given to a governmental or charitable organization. |
| IV. | Employee awards for safety achievements are always excluded from income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Statements II and III are correct. |
|   | d.  | Statements I and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 43. Nora, a single individual age 60, receives a gold watch worth $700 during her retirement luncheon for her long tenure with the company. The award was made under a nonqualified plan.  How much of the award must Nora recognize in her gross income for the current year?

|  |  |  |
| --- | --- | --- |
|   | a.  | $- 0 - |
|   | b.  | $300 |
|   | c.  | $400 |
|   | d.  | $500 |
|   | e.  | $700 |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 44. Teresa won $9,000 playing the Illinois lottery. Which of the following statements is/are correct?

|  |  |
| --- | --- |
| I. | Teresa must include the $9,000 in gross income. |
| II. | The all-inclusive income concept applies to this situation. |
| III. | Legislative grace allows Teresa to exclude lottery winnings from recognition. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Only statement III is correct. |
|   | d.  | Statements I and II are correct. |
|   | e.  | Statements I, II, and III are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 45. Gary won the Nobel Prize in Economics. He receives $1.2 million from the Royal Academy of Sciences in Stockholm. Does he have a taxable income from this award?

|  |  |
| --- | --- |
| I. | If he keeps the prize money, he must include the award in his gross income. |
| II. | If he tells the Academy to contribute the award to a charitable organization, the amount of the award is excludable from his gross income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 46. Paul won the Nobel Prize for Literature. He is awarded $1,000,000.

|  |  |
| --- | --- |
| I. | In general, the award must be included in gross income. |
| II. | The award may be excluded if he gives it to a qualified charity. |
| III. | The award may be excluded if he gives it to the U.S. government. |
| IV. | Awards for literary achievement are not taxable. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Statements I, II, and III are correct. |
|   | d.  | Only statement IV is correct. |
|   | e.  | Statements I, II, and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 47. Janelle receives a sterling silver tea set valued at $500 from her employer during her retirement dinner for her long years of service. The employer has a tradition of giving awards to some retiring employees but has no qualified plan.

|  |  |
| --- | --- |
| I. | $400 is excludable from Janelle's gross income. |
| II. | The $500 is excludable even if her employer gives awards to only its top executives. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 48. Which of the following statements is/are correct?

|  |  |
| --- | --- |
| I. | Maria receives a necklace worth $300 from her employer in recognition of her production unit's safety record at the company's annual meeting. Maria is not taxed on the $300. |
| II. | Reggie opens a savings account at Mid Financial Savings and Loan. For opening the account, he receives a microwave worth $200. On December 31, his account is credited for $300 of interest income. Reggie must report $500 of income. |
| III. | Manu receives a salary of $80,000 as CEO of Camp's Cooking Crockery. Manu owns 60% of Camp's, which is organized as an S corporation. Camp's taxable income for the current year is $300,000, and Camp's pays $100,000 of dividends. Manu must recognize $360,000 of income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Statements I, II, and III are correct. |
|   | b.  | Statements I and II are correct. |
|   | c.  | Statements II and III are correct |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 49. Ona is a retired schoolteacher who receives a pension of $800 per month (Ona made no payments into the pension plan) and $2,000 of Social Security benefits per month. Ona's adjusted gross income is:

|  |  |  |
| --- | --- | --- |
|   | a.  | $9,600. |
|   | b.  | $13,900. |
|   | c.  | $21,900. |
|   | d.  | $24,000. |
|   | e.  | $33,600. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 50. Rae is a retired corporate executive. He and his wife, Pat, receive pensions totaling $82,000 and Social Security benefits totaling $8,000 during the current year. Rae and Pat's adjusted gross income is:

|  |  |  |
| --- | --- | --- |
|   | a.  | $82,000. |
|   | b.  | $86,000. |
|   | c.  | $87,400. |
|   | d.  | $88,800. |
|   | e.  | $90,000. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 51. Binney is a retired auto mechanic. He and his wife, Jennie, receive taxable pensions totaling $35,000, tax-exempt interest income totaling $8,000, and Social Security benefits totaling $6,000 during the current year. Assuming that they had no other items of income or deductions for adjusted gross income, Binney and Jennie's adjusted gross income is:

|  |  |  |
| --- | --- | --- |
|   | a.  | $35,000. |
|   | b.  | $36,700. |
|   | c.  | $38,000. |
|   | d.  | $39,700. |
|   | e.  | $40,100. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 52. Lyle and Louise are retired and living on income from their investments and Social Security benefits. During the current year, they receive the following:

|  |  |
| --- | --- |
| Cash dividends on stock investments | $28,000 |
| Interest on municipal bonds | 5,000 |
| Social Security benefits | 18,000 |

Lyle and Louise's adjusted gross income is:

|  |  |  |
| --- | --- | --- |
|   | a.  | $28,000. |
|   | b.  | $33,000. |
|   | c.  | $37,000. |
|   | d.  | $48,000. |
|   | e.  | $41,300. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 53. Marvin and Simone are a retired couple living on income from their investments and Social Security benefits. During the current year, they receive the following:

|  |  |
| --- | --- |
| Consulting fee from Burton Industries | $35,000 |
| Interest on municipal bonds | 7,000 |
| Social Security benefits | 20,000 |

Marvin and Simone's adjusted gross income is:

|  |  |  |
| --- | --- | --- |
|   | a.  | $45,000. |
|   | b.  | $47,800. |
|   | c.  | $52,000. |
|   | d.  | $55,000. |
|   | e.  | $61,000. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 54. Hector and Nicole are retired. During the current year, they receive $11,000 from a qualified pension plan, $3,000 of dividends on common stock holdings, $6,000 of tax-exempt interest, and $10,000 of Social Security benefits. Hector and Nicole's adjusted gross income is:

|  |  |  |
| --- | --- | --- |
|   | a.  | $14,000. |
|   | b.  | $19,000. |
|   | c.  | $24,000. |
|   | d.  | $30,000. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 55. Marvin and Stacy are retired. During the current year, they receive $10,000 in Social Security benefits. They have $45,000 of other taxable gross income and receive $23,000 of municipal bond interest. The taxable portion of the $10,000 Social Security payment is:

|  |  |  |
| --- | --- | --- |
|   | a.  | $-0-. |
|   | b.  | $5,000. |
|   | c.  | $8,500. |
|   | d.  | $10,000. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 56. Nellie, a single individual age 77, receives Social Security benefits of $7,000 during the current year. Her only other income consists of $5,000 of interest from bank CDs and $1,000 of tax-exempt interest distributed from a trust fund. Nellie's gross income is:

|  |  |  |
| --- | --- | --- |
|   | a.  | $- 0 -. |
|   | b.  | $5,000. |
|   | c.  | $8,500. |
|   | d.  | $12,000. |
|   | e.  | $13,000. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 57. In what circumstances would some portion of the Social Security benefits received by a single taxpayer be subject to taxation? Assume that all sources of income are listed.

|  |  |  |
| --- | --- | --- |
|   | a.  | The taxpayer's only income consists of $24,000 in Social Security benefits. |
|   | b.  | The taxpayer receives $12,000 in Social Security benefits, dividend income of $6,000, and municipal bond interest of $3,000. |
|   | c.  | The taxpayer receives $10,000 in Social Security benefits, qualified pension plan benefits of $13,000, and municipal bond interest of $8,000. |
|   | d.  | The taxpayer receives $20,000 in Social Security benefits and qualified pension plan benefits of $14,000. |
|   | e.  | One-half of Social Security benefits are always taxable. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 58. Todd and Fiona are negotiating their divorce settlement. Todd has offered to pay Fiona $12,000 each year for 10 years, but payments cease upon Fiona's death. Assuming this proposition is finalized in 2019, what are its tax implications?

|  |  |
| --- | --- |
| I. | Fiona must recognize gross income when the money is received. |
| II. | Todd has a deduction for adjusted gross income in the year of payment. |
| III. | Since the payments are in cash and there is no obligation to pay more after Fiona's death, the payments are classified as alimony. |
| IV. | If the payments qualify as child support, Fiona recognizes no gross income and Todd has no deduction from adjusted gross income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement IV is correct. |
|   | c.  | Statements I and II are correct. |
|   | d.  | Statements I, II, and III are correct. |
|   | e.  | Statements I, II, III, and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 59. Frank and Lilly are negotiating their divorce settlement. Frank has offered to pay Lilly $12,000 each year for 10 years, but payments cease upon Lilly's death. Assuming this proposition is finalized in 2019, what are its tax implications?

|  |  |
| --- | --- |
| I. | Lilly must recognize gross income when the money is received. |
| II. | Frank has a deduction for adjusted gross income in the year of payment. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 60. Waldo and Fern are negotiating their divorce settlement. Waldo has offered to pay Fern $12,000 each year for a guaranteed 10 years. What are the tax implications of this proposition?

|  |  |
| --- | --- |
| I. | Since the payments are periodic and in cash, the payments qualify as alimony. |
| II. | If the payments qualify as child support, Fern recognizes gross income and Waldo has a deduction from adjusted gross income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 61. Ralph and Renee are negotiating their divorce settlement that will be finalized in 2019. Renee has an option of taking a property settlement of $100,000 or alimony payments of $12,000 per year for 10 years. Without considering the time value of money, which of the following statements is/are true?

|  |  |
| --- | --- |
| I. | If Renee expects that she will be in the 32% marginal tax bracket, she should take the property settlement of $100,000. |
| II. | If Renee expects that she will be in the 32% marginal tax bracket, she should take the alimony of $12,000 per year for 10 years. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 62. As a result of their 2018 divorce agreement, Carlos made the following payments to Michelle, his former wife, in 2019:

|  |  |
| --- | --- |
| • | He transferred the family car to Michelle. The car cost them $20,000 and was worth $10,000 at the time that he gave it to Michelle. |
| • | Carlos paid Michelle 12 monthly cash payments of $1,000 each. These payments are to continue as long as Michelle lives or until their son is 19 years. When their son attains age 19, the payments will be reduced to $600 a month. |
| • | On June 6, Carlos paid Michelle a single cash payment of $70,000 to help her settle in a new home. Carlos kept the family home. |

How much gross income should Michelle report as a result of the transfers given above?

|  |  |  |
| --- | --- | --- |
|   | a.  | $7,200 |
|   | b.  | $12,000 |
|   | c.  | $17,200 |
|   | d.  | $87,200 |
|   | e.  | $92,000 |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 63. Glenn and Vera divorce during 2019. Per their 2019 divorce agreement, Glenn receives their former personal residence valued at $180,000 with a basis of $100,000. Also, Glenn will pay Vera $5,000 annually for 8 years. If Vera dies before the end of the 8 years, the balance of the payments is to be paid to Vera's estate in a lump sum. The couple has not lived together for the past 2 years.

|  |  |  |
| --- | --- | --- |
|   | a.  | Glenn can deduct $5,000 annually for alimony paid to Vera. |
|   | b.  | Vera can deduct $40,000 (1/2 of the unrealized gain on the house). |
|   | c.  | Vera does not recognize any income from the property and/or cash transactions. |
|   | d.  | Vera must recognize $40,000 as a gain on the disposition of her interest in the house. |
|   | e.  | Vera must recognize all the cash received as alimony income. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 64. Al and Peggy divorce in 2019. As part of their 2019 divorce agreement, Peggy is to pay Al $70,000 for his share of their home (the home's fair market value is $140,000). Also, Peggy agrees to pay Al $1,000 monthly. The payment represents the financial support for their 15-year-old son, Bud. It will cease upon Bud's 23rd birthday or college graduation, whichever comes first. Which of the following explain(s) the tax effects of these events?

|  |  |
| --- | --- |
| I. | Peggy can deduct $12,000 annually for the monthly payments made this year. |
| II. | Al does not recognize the $1,000 monthly payments as income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 65. The intent of the alimony recapture rules is to:

|  |  |  |
| --- | --- | --- |
|   | a.  | prevent the payee from having a large tax liability when there is not an adequate wherewithal to pay. |
|   | b.  | prevent former spouses from skipping out of their obligations to pay the other spouse. |
|   | c.  | reclassify property settlements as capital gains rather than ordinary income. |
|   | d.  | prevent child support from being disguised as alimony. |
|   | e.  | prevent tax deductions for property settlements disguised as alimony payments. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 66. Sonya and Butch divorce during 2019. Their 2019 divorce agreement requires Sonya to pay Butch alimony of $2,500 monthly. When their son, Bubba, attains the earliest of either the age 23 or graduates from college, the payments will cease.

|  |  |
| --- | --- |
| I. | Butch must recognize gross income of $2,500 monthly. |
| II. | Sonya may deduct $2,500 monthly from her gross income. |
| III. | Butch will not recognize any gross income due to the payments. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Statements I and II are correct. |
|   | b.  | Only statement I is correct. |
|   | c.  | Only statement II is correct. |
|   | d.  | Only statement III is correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 67. How much gross income does Faith have from the following items of economic income?

|  |  |
| --- | --- |
| • | Received cash gift of $6,000 from parents |
| • | Received $12,000 in alimony payments from former spouse (2019 agreement) |
| • | Received $18,000 in child support payments from former spouse (2019 agreement) |
| • | Won $6,000 in a slot machine in Las Vegas |
| • | Faith’s vacation home on Lake Tahoe increased in value by $15,000. |
| • | Collected $14,000 in unemployment benefits |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | $18,000 |
|   | b.  | $30,000 |
|   | c.  | $32,000 |
|   | d.  | $38,000 |
|   | e.  | $50,000 |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 68. How much gross income does Ron have from the following items of economic income?

|  |  |
| --- | --- |
| • | Received cash gift of $5,000 from parents |
| • | Received $12,000 in alimony payments and $6,000 in child support from her former spouse (2019 agreement) |
| • | Won $4,000 in Indiana lottery scratch-off game |
| • | Investment in IBM stock increased in value by $15,000. |
| • | Collected $12,000 in unemployment benefits |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | $16,000 |
|   | b.  | $28,000 |
|   | c.  | $33,000 |
|   | d.  | $34,000 |
|   | e.  | $54,000 |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 69. One type of imputed income that always escapes taxation is:

|  |  |  |
| --- | --- | --- |
|   | a.  | bargain purchases by employees. |
|   | b.  | value of growing one's own vegetables for personal consumption. |
|   | c.  | payment of personal expenses by a corporation in which stock is owned. |
|   | d.  | interest-free loan from parents. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 70. Under the imputed interest rules, gift loans between a daughter (lender) and her mother (borrower) may result in:

|  |  |
| --- | --- |
| I. | imputed interest income recognized by the mother. |
| II. | imputed interest deduction by the daughter. |
| III. | imputed interest income recognized by the daughter. |
| IV. | deduction allowed for imputed interest expense by the mother. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Statements I, II, and III are correct. |
|   | b.  | Statements I and IV are correct. |
|   | c.  | Statements I and II are correct. |
|   | d.  | Only statement III is correct. |
|   | e.  | Statements III and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 71. Which of the following never generate(s) taxable income?

|  |  |
| --- | --- |
| I. | Interest-free loan from family members |
| II. | Interest-free loan from the employer |
| III. | Interest-free loan under $10,000 |
| IV. | Interest-free loan over $100,000 |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Statements I and III are correct. |
|   | c.  | Statements I and II, and III are correct. |
|   | d.  | Only statement III is correct. |
|   | e.  | Statements II and III are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 72. Which of the following always generate taxable income?

|  |  |
| --- | --- |
| I. | Interest-free loan over $10,000 from family members |
| II. | Interest-free loan over $10,000 from the employer |
| III. | Interest-free loan under $10,000 |
| IV. | Interest-free loan over $100,000 |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Statements I, II and IV are correct. |
|   | b.  | Statements II and III are correct. |
|   | c.  | Statements I and IV are correct. |
|   | d.  | Only statement IV is correct. |
|   | e.  | Statements II and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 73. On January 1, Sandi borrows $40,000 from G&H Accounting firm, her employer, to pay off charge accounts and other personal loans. Sandi must repay the $40,000 loan at the end of 5 years. Because Sandi has been loyal to her job, G&H is not charging Sandi interest on the $40,000 loan. The applicable federal interest rate is 6%. If Sandi has total net investment income of $200 for the current year, then:

|  |  |
| --- | --- |
| I. | Sandi has compensation income of $2,400. |
| II. | Sandi has a nontaxable gift from her employer of $2,400. |
| III. | G&H is allowed a deduction for $2,400 of compensation paid to Sandi. |
| IV. | there are no tax effects because Sandi's net investment income is less than $1,000. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Statements I and III are correct. |
|   | d.  | Statements II and IV are correct. |
|   | e.  | Statements II and III are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 74. Nathan loans $50,000 to Ramona on January 1 of the current year. The terms of the loan require Ramona to pay Nathan $5,000 per year on December 31 each year for the next 10 years (i.e., no interest is charged on the loan). Assume that the applicable federal rate is 6% and Ramona has total investment income of $1,200 during the current year.

|  |  |
| --- | --- |
| I. | If Ramona is Nathan's sister, Nathan must recognize $3,000 of interest income from the loan. |
| II. | If Ramona is an employee of Nathan's, Nathan must recognize interest income of $3,000 and receives a deduction for compensation paid of $3,000. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 75. Art has worked for Denver's Diamond Dealers (DDD) for 10 years. During the current year, Art marries and moves from his downtown apartment to a house in the suburbs. Before he was married, Art always rode the bus to work. Because there is no bus service to his new home, Art needs to purchase a car. Wayne, the owner of DDD, gives Art $17,000 to purchase a used car. Which of the following statements concerning the $17,000 payment is/are correct?

|  |  |
| --- | --- |
| I. | If DDD does not require Art to repay the $17,000, Art has $17,000 of compensation income. |
| II. | If DDD requires Art to repay the $17,000, Art has no compensation income from the receipt of $17,000. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 76. Imputed interest rules and policies include which of the following?

|  |  |
| --- | --- |
| I. | Gift loans have no income tax effect to the lender. |
| II. | Any loan of $10,000 or less is exempted from imputed interest rules. |
| III. | On gift loans of $100,000 or less, the imputed interest on the loan cannot exceed the borrower's net investment income for the year. |
| IV. | With a loan to a shareholder, a corporation can deduct the imputed payment. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Statements I and IV are correct. |
|   | c.  | Only statement II is correct. |
|   | d.  | Statements II and III are correct. |
|   | e.  | Statements II, III, and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 77. Karl is an employee of Cars-R-Us. As part of their employment agreement, Cars-R-Us gives Karl an interest-free loan of $1,000,000 to assist in the purchase of a car dealership. Assume that the federal rate of interest is 8%. What is the tax treatment of the loan?

|  |  |
| --- | --- |
| I. | The arrangement has no tax consequences for Karl. |
| II. | Cars-R-Us is deemed to have paid Karl a compensation of $80,000. |
| III. | Karl is deemed to have paid Cars-R-Us $80,000 of interest. |
| IV. | Cars-R-Us’ net income tax effect is zero due to this arrangement. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Statements I, II, and IV are correct. |
|   | c.  | Only statement III is correct. |
|   | d.  | Statements I, II, and III are correct. |
|   | e.  | Statements II, III, and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 78. Which of the following interest-free loans is subject to the imputed interest rules (i.e., interest must be imputed on the loan)?

|  |  |
| --- | --- |
| I. | Marilyn loans $24,000 to her grandmother, and she uses the money to pay personal expenses and take a vacation. Her grandmother's sole income is from Social Security. |
| II. | Pineview Corporation loans $20,000 to Catherine, an employee. Catherine uses the proceeds as a down payment on a house. Catherine's net investment income for the year is $300. |
| III. | Scott loans $65,000 to his son. His son uses the money to open a new business. During the current year, the business shows a loss and his son has no other sources of income. |
| IV. | Alaric Corporation loans $27,000 to its principal shareholder. The shareholder uses the funds to buy additional shares of stock in Alaric. The shareholder is deemed to receive $8,500 of dividends from Alaric during the year. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement II is correct. |
|   | b.  | Statements I and III are correct. |
|   | c.  | Statements II and IV are correct. |
|   | d.  | Statements I and IV are correct. |
|   | e.  | Statements II and III are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 79. Which of the following interest-free loans is subject to the imputed interest rules?

|  |  |
| --- | --- |
| I. | Lena needed $5,000 to pay off some gambling debts. Her employer loans her the $5,000. |
| II. | Sherry loans her son $130,000 to purchase a motor home to use in his landscaping business. Her son has no investment income for the year. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only loan I |
|   | b.  | Only loan II |
|   | c.  | Both loans |
|   | d.  | None of the loans |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 80. Which of the following interest-free loans is subject to the imputed interest rules (i.e., interest must be imputed on the loan)?

|  |  |
| --- | --- |
| I. | Benito loans $250,000 to his son. His son uses the money to open a new business. During the current year, the business shows a loss and his son has no other sources of income. |
| II. | Bisbane Corporation loans $8,000 to its principal shareholder. The shareholder uses the funds to buy additional shares of stock in Arcane. The shareholder is deemed to receive $4,000 of dividends from Brisbane during the year. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only loan I |
|   | b.  | Only loan II |
|   | c.  | Both loans |
|   | d.  | None of the two loans |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 81. Roberto is a furniture salesman for Gerald's Furniture Mart. Roberto purchases a bedroom suite from Gerald's for $8,000. The sticker price is $11,000. Gerald's policy is to discount all customer purchases for up to $1,000 on the sticker price for purchases over $10,000. What is the tax treatment of Roberto's furniture purchase?

|  |  |
| --- | --- |
| I. | Roberto must include $3,000 in his gross income. |
| II. | Gerald's Furniture Mart can deduct $2,000 as compensation expense in addition to properly accounting for the sale of the furniture. |
| III. | Roberto does not need to account for the furniture purchase since it is for his personal use. |
| IV. | Roberto has imputed income because of the nature of the furniture purchase. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement III is correct. |
|   | c.  | Statements I and IV are correct. |
|   | d.  | Only statement IV is correct. |
|   | e.  | Statements II and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 82. Jerry is a furniture salesman for Ashland's Furniture Mart. Jerry purchases a bedroom suite from Ashland's for $10,000. The sticker price is $14,000. Ashland's policy is to discount all customer purchases for up to $2,000 on the sticker price for purchases over $10,000. What is the tax treatment of Jerry's furniture purchase?

|  |  |
| --- | --- |
| I. | Jerry must include $4,000 in his gross income. |
| II. | Ashland's Furniture Mart can deduct $2,000 as compensation expense in addition to properly accounting for the sale of the furniture. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 83. Stephen is a furniture salesman for Foster's Furniture Mart. Stephen purchases a bedroom suite from Foster's for $8,000. The sticker price is $11,000. Foster's policy is to discount all customer purchases for up to $1,000 on the sticker price for purchases over $10,000. What is the tax treatment of Stephen's furniture purchase?

|  |  |
| --- | --- |
| I. | Stephen does not need to account for the furniture purchase since it is for his personal use. |
| II. | Stephen has imputed income because of the nature of the furniture purchase. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 84. Patti sells a painting that has a fair market value of $9,000 to James for $6,000. Which of the following statements about the tax effect of the sale is/are correct?

|  |  |
| --- | --- |
| I. | If James is an employee of Patti's, no income is recognized from the sale. |
| II. | If James is Patti's brother, James does not recognize any income from the sale. |
| III. | If Patti is an art dealer and she sold the painting to James because she needed cash quickly, James does not recognize any imputed income from the sale. |
| IV. | If James owns 60% of Patti's company, James does not recognize any income from the sale. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement II is correct. |
|   | b.  | Only statement III is correct. |
|   | c.  | Statements II and III are correct. |
|   | d.  | Statements II, III, and IV are correct. |
|   | e.  | Statements I, II, III, and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 85. Elise sells a painting that has a fair market value of $9,000 to Jon for $6,000. Which of the following statements about the tax effect of the sale is/are correct?

|  |  |
| --- | --- |
| I. | If Jon is an employee of Elise's, no income is recognized from the sale. |
| II. | If Jon is Elise's brother, Jon does not recognize any income from the sale. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 86. Elizabeth sells a painting that has a fair market value of $9,000 to Jonathan for $6,000. Which of the following statements about the tax effect of the sale is/are correct?

|  |  |
| --- | --- |
| I. | If Elizabeth is an art dealer and she sold the painting to Jonathan because she needed cash quickly, Jonathan does not recognize any income from the sale. |
| II. | If Jonathan owns 60% of Elizabeth's company, Jonathan does not recognize any income from the sale. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 87. Dahlia rents a condo owned by Bonnie. Both individuals are cash basis taxpayers. Dahlia uses the condo as her personal residence. Dahlia pays Bonnie $1,000 monthly and pays $1,200 on October 1st and April 1st of each year as part of the lease agreement. The $1,200 payments are made directly to the county treasurer for real estate property taxes. What is the income tax treatment of these events?

|  |  |
| --- | --- |
| I. | Bonnie can deduct the $1,200 payments for adjusted gross income as property tax. |
| II. | Bonnie includes the $1,000 monthly receipts in her gross income. |
| III. | Bonnie must include the $1,200 payments in her gross income. |
| IV. | Dahlia can deduct the $1,000 monthly payments from her adjusted gross income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement II is correct. |
|   | b.  | Statements I, II, and IV are correct. |
|   | c.  | Only statement III is correct. |
|   | d.  | Statements I, II, and III are correct. |
|   | e.  | Statements II, III, and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 88. Which of the following items is not a capital asset in the hands of the taxpayer?

|  |  |  |
| --- | --- | --- |
|   | a.  | The taxpayer has a set of wrenches he uses to work on his personal auto. |
|   | b.  | The taxpayer has a $6,000 wedding dress she keeps as a remembrance of her wedding. |
|   | c.  | The taxpayer owns city of Topeka bonds. |
|   | d.  | The taxpayer is an amateur golfer but has a set of championship golf clubs. |
|   | e.  | All of the items given above are capital assets. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 89. Which of the following items is a capital asset in the hands of the taxpayer?

|  |  |  |
| --- | --- | --- |
|   | a.  | The taxpayer owns a 10-year-old Harley-Davidson motorcycle. |
|   | b.  | The taxpayer owns a used car lot. He owns a 1962 Cadillac that is for sale on the lot. |
|   | c.  | The taxpayer owns a notebook computer that he carries with him to his clients for work purposes. |
|   | d.  | The taxpayer, a farmer, has a prize-winning steer in his herd. |
|   | e.  | None of the items given above are capital assets. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 90. Benjamin has the following capital gains and losses for the current year:

|  |  |
| --- | --- |
| Long-term capital loss | $(13,000) |
| Long-term capital gain | 6,000  |
| Short-term capital loss | (10,000) |
| Short-term capital gain | 12,000  |

What is Benjamin's net capital gain or loss for the year?

|  |  |  |
| --- | --- | --- |
|   | a.  | A net long-term capital loss of $7,000 |
|   | b.  | A net short-term capital gain of $2,000 |
|   | c.  | A net long-term capital loss of $5,000 |
|   | d.  | A net short-term capital gain of $1,000 |
|   | e.  | A net long-term capital loss of $3,000 |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 91. Helena and Irwin are married taxpayers who file jointly. Their taxable income before considering capital gains and losses is $120,000. They have long-term capital gains of $8,000, short-term capital losses of $4,000, and short-term capital gains of $5,000. What are the tax effects of these events?

|  |  |
| --- | --- |
| I. | The short-term capital losses can offset only $3,000 of the short-term capital gains. |
| II. | The net capital gains will add $1,420 to the couple's tax liability. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 92. Nora receives a salary of $55,000 during the current year. She sells some land that she held as an investment at a loss of $15,000 and some stock at a gain of $10,000. Nora's adjusted gross income is:

|  |  |  |
| --- | --- | --- |
|   | a.  | $50,000. |
|   | b.  | $52,000. |
|   | c.  | $55,000. |
|   | d.  | $62,000. |
|   | e.  | $65,000. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 93. Given below are Mario's capital gains and losses for two consecutive years. What is the effect of the capital gains and losses on Mario's taxable income for each year?

|  |  |  |
| --- | --- | --- |
|   | First | Second |
|   | Year | Year |
| Short-term capital gain | $12,000  | $ -0- |
| Long-term capital gain | 11,000  | 16,000  |
| Short-term capital loss | (9,000) | (2,000) |
| Long-term capital loss | (23,000) | (5,000) |

    First       Second     Year     Year

|  |  |  |
| --- | --- | --- |
|   | a.  | $(9,000) $ 9,000 |
|   | b.  | $ 3,000 $ 1,000 |
|   | c.  | $(3,000) $ 3,000 |
|   | d.  | $(3,000) $(3,000) |
|   | e.  | $(3,000) $ -0- |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 94. Given below are Belinda's capital gains and losses for two consecutive years. What is the effect of the gains and losses on Belinda's taxable income for each year?

|  |  |  |
| --- | --- | --- |
|   | First | Second |
|   | Year | Year |
| Short-term capital gain | $-0- | $4,000  |
| Long-term capital gain | 13,000  | 6,000  |
| Short-term capital loss | (3,000) | (15,000) |
| Long-term capital loss | (12,000) | -0- |

​   First       Second  Year         Year

|  |  |  |
| --- | --- | --- |
|   | a.  | $10,000 $ 7,000 |
|   | b.  | $(2,000) $ (3,000) |
|   | c.  | $(3,000) $ (3,000) |
|   | d.  | $(2,000) $ (5,000) |
|   | e.  | $1,000 $ 3,000 |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 95. Boris, a single individual, has two sales of stock during the current year. The first sale produces a short-term loss of $27,000, and the second sale results in a long-term gain of $57,000. Boris's taxable income without considering the gain is $125,000. Boris's stock transactions will increase his taxable income by:

|  |  |  |
| --- | --- | --- |
|   | a.  | $-0-. |
|   | b.  | $30,000. |
|   | c.  | $34,000. |
|   | d.  | $54,000. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 96. Chip, a single individual, has two sales of stock during the current year. The first sale produces a short-term loss of $10,000, and the second sale results in a long-term gain of $40,000. Chip's taxable income without considering the gain is $150,000. Chip's stock transactions will increase his income tax liability by:

|  |  |  |
| --- | --- | --- |
|   | a.  | $3,000. |
|   | b.  | $4,500. |
|   | c.  | $6,600. |
|   | d.  | $7,200. |
|   | e.  | $9,000. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 97. Ira sells two of his personal automobiles, a Dodge and an Edsel, during the current tax year. The Dodge cost Ira $8,000, and the Edsel's cost was $3,000 when they were acquired 5 years ago. The Dodge is sold for $1,000 on April 20, and the Edsel is sold for $15,000 on July 15. What is the tax treatment of these sales?

|  |  |
| --- | --- |
| I. | Both cars are capital assets. |
| II. | The net income tax effect of these sales is zero. |
| III. | Ira must recognize a long-term capital gain of $12,000. |
| IV. | Ira must recognize a net long-term capital gain of $5,000. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Statements I and III are correct. |
|   | d.  | Statements I and IV are correct. |
|   | e.  | Statements I, II, and IV correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 98. Anna receives a salary of $42,000 during the current year. She sells some land that she held as an investment at a loss of $7,000 and some stock at a gain of $11,000. Anna's adjusted gross income is:

|  |  |  |
| --- | --- | --- |
|   | a.  | $42,000. |
|   | b.  | $46,000. |
|   | c.  | $50,000. |
|   | d.  | $53,000. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 99. Andrea has the following capital gains and losses during the current year:

|  |  |
| --- | --- |
| Short-term capital loss | $(4,000) |
| Collectibles gain | 6,000  |
| Long-term capital gain | 2,000  |

For tax calculation purposes, the net result of the above is:

|  |  |  |
| --- | --- | --- |
|   | a.  | a long-term gain of $8,000; a short-term capital loss of $4,000. |
|   | b.  | a net long-term capital gain of $4,000. |
|   | c.  | collectibles gains of $2,000; a long-term capital gain of $2,000. |
|   | d.  | collectibles gains of $6,000; a short-term capital loss of $2,000. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 100. Shasta has the following capital gains and losses and qualified dividend income during the current year:

|  |  |
| --- | --- |
| Short-term capital loss | $(4,000) |
| Collectibles gain | 6,000  |
| Long-term capital gain | 2,000  |
| Qualified dividend income | 3,000 |

If Shasta's marginal tax rate is 32%, what is the effect of the gains, losses, and incomes given above on her taxable income and income tax liability?  Income     Tax Liability

|  |  |  |
| --- | --- | --- |
|   | a.  | $7,000 increase $1,050 increase |
|   | b.  | $7,000 increase $1,310 increase |
|   | c.  | $8,000 increase $2,560 increase |
|   | d.  | $7,000 increase $2,240 increase |
|   | e.  | $9,000 increase $2,880 increase |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 101. Allen has the following capital gains and losses and qualified dividend income during the current year:

|  |  |
| --- | --- |
| Short-term capital gain | $4,000  |
| Collectibles loss | (5,000) |
| Long-term capital gain |    1,000  |
| Qualified dividend income | 3,000 |

Allen's capital gain/loss position for the year is:

|  |  |  |
| --- | --- | --- |
|   | a.  | a long-term gain of $1,000; a short-term capital gain of $2,000. |
|   | b.  | a net short-term capital gain of $1,000. |
|   | c.  | a short-term capital gain of $4,000; a long-term capital loss of $1,000. |
|   | d.  | a net short-term capital gain of $3,000. |
|   | e.  | a net capital gain of $-0-. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 102. Sanderson has the following capital gains and losses and qualified dividend income during the current year:

|  |  |
| --- | --- |
| Short-term capital gain | $6,000  |
| Collectibles loss | (5,000) |
| Long-term capital gain | 1,000  |
| Qualified dividend income | 3,000 |

If Sanderson's marginal tax rate is 32%, what is the effect of these transactions on his taxable income and income tax liability?Taxable Income       Tax Liability

|  |  |  |
| --- | --- | --- |
|   | a.  | $7,000 increase $1,770 increase |
|   | b.  | $5,000 increase $ 633 increase |
|   | c.  | $5,000 increase $1,600 increase |
|   | d.  | $5,000 increase $ 750 increase |
|   | e.  | $5,000 increase $1,090 increase |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 103. Andy has the following capital gains and losses during the current year:

|  |  |
| --- | --- |
| Short-term capital gain | $4,000  |
| Short-term capital loss | (9,000) |
| Collectibles loss | (2,000) |
| Long-term capital gain | 1,000  |

Andy's capital gains and losses will:

|  |  |  |
| --- | --- | --- |
|   | a.  | increase taxable income by $2,000. |
|   | b.  | decrease taxable income by $6,000. |
|   | c.  | decrease taxable income by $3,000. |
|   | d.  | increase taxable income by $4,000. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 104. Alan has the following capital gains and losses during the current year:

|  |  |
| --- | --- |
| Short-term capital loss | $(4,000) |
| Collectibles gain | 3,000  |
| Long-term capital gain | 8,000  |

Alan's capital gain/loss position for the year is:

|  |  |  |
| --- | --- | --- |
|   | a.  | a long-term capital gain of $8,000; a short-term capital loss of $1,000. |
|   | b.  | a net long-term capital gain of $7,000. |
|   | c.  | a net short-term capital loss of $4,000; a net long-term capital gain of $11,000. |
|   | d.  | a collectibles gain of $3,000; a long-term capital gain of $4,000. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 105. Alan has the following capital gains and losses during the current year:

|  |  |
| --- | --- |
| Short-term capital loss | $(4,000) |
| Collectibles gain | 3,000  |
| Long-term capital gain | 8,000  |

If Alan's marginal tax rate is 32%, what is the effect of the capital gains and losses on his taxable income and income tax liability?     Income            Tax Liability

|  |  |  |
| --- | --- | --- |
|   | a.  | $7,000 increase $2,240 increase |
|   | b.  | $8,000 increase $1,840 increase |
|   | c.  | $7,000 increase $1,400 increase |
|   | d.  | $8,000 increase $1,200 increase |
|   | e.  | $7,000 increase $1,050 increase |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 106. Ellie has the following capital gains and losses and qualified dividend income during the current year:

|  |  |
| --- | --- |
| Short-term capital loss | $(10,000) |
| Collectibles loss | (4,000) |
| Long-term capital gain | 5,000  |
| Qualified dividend income | 10,000 |

​The effect of the gains, losses, and incomes given above on the current year's taxable income is:

|  |  |  |
| --- | --- | --- |
|   | a.  | a long-term gain of $3,000; a short-term capital loss of $10,000. |
|   | b.  | a long-term capital gain of $7,000; a short-term capital loss of $14,000. |
|   | c.  | a collectibles loss of $1,000; a net short-term capital loss of $5,000; a qualified dividend income of $10,000. |
|   | d.  | a net short-term capital loss of $9,000; a qualified dividend income of $10,000. |
|   | e.  | a net capital loss of $3,000; a qualified dividend income of $10,000. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 107. Angelica has the following capital gains and losses during the current year:

|  |  |
| --- | --- |
| Short-term capital loss | $(10,000) |
| Collectibles loss | (4,000) |
| Long-term capital gain | 5,000  |
| Qualified dividend income | 10,000 |

If Angelica's marginal tax rate is 32%, what is the effect of the transactions given above on her taxable income and income tax liability?                  Income          Tax Liability

|  |  |  |
| --- | --- | --- |
|   | a.  | $1,000 increase $ 280 increase |
|   | b.  | $7,000 increase $ 540 increase |
|   | c.  | $1,000 increase $320 increase |
|   | d.  | $7,000 increase $1,050 increase |
|   | e.  | $1,000 increase $ 150 increase |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 108. Dunbar, a single taxpayer, purchased 300 shares of Sweetwater, Inc., stock on October 14, 2016, for $3,000. He sells the stock on August 22, 2019, for $4,000. Dunbar has no other capital asset transactions in 2019.

|  |  |
| --- | --- |
| I. | If Dunbar's taxable income without considering the stock sale is $93,000, the sale of the stock will increase his income tax liability by $220. |
| II. | If Dunbar's taxable income without considering the stock sale is $13,000, the sale of the stock will not increase his income tax liability. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 109. Ronald, a single taxpayer, purchased 300 shares of Jasmine Inc. stock on October 14, 2016, for $4,000. He sells the stock on August 22, 2019, for $2,000. Ronald has no other capital asset transactions in 2019.

|  |  |
| --- | --- |
| I. | If Ronald's taxable income without considering the stock sale is $113,000, the sale of the stock will decrease his income tax liability by $480. |
| II. | If Ronald's taxable income without considering the stock sale is $13,000, the sale of the stock will decrease his income tax liability by $240. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 110. Which of the following tax rates applies to an individual taxpayer in the 32% marginal tax rate bracket?     Type of gain/loss Tax Rate

|  |  |  |
| --- | --- | --- |
|   | a.  | Collectibles loss 28% |
|   | b.  | Short-term gain 28% |
|   | c.  | Long-term gain 15% |
|   | d.  | Long-term loss 15% |
|   | e.  | Collectibles gain 32% |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 111. Donna owns a cleaning service. Reed, a customer, receives Donna's bill of $65 for October 2019 services on October 31, 2019. Reed pays the $65 on January 4, 2020.

|  |  |
| --- | --- |
| I. | If Donna is a cash basis taxpayer, she recognizes the income in 2020. |
| II. | If Donna is an accrual basis taxpayer, she will recognize the $65 in 2019. |
| III. | Donna will recognize the $65 in 2019 regardless of the accounting method, because that is when she earned the income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Only statement III is correct. |
|   | d.  | Statements I and II are correct. |
|   | e.  | Statements I and III are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 112. Willis is a cash basis taxpayer who is in the commercial lending business. Which of the following statements regarding loans that he made in the current year is/are correct?

|  |  |
| --- | --- |
| I. | A $10,000 one-year loan with interest at 12% is made on April 1. The principal and interest are due at maturity. Willis must recognize $900 of interest income this year. |
| II. | A $10,000 one-year loan discounted at 12% is made on April 1. Willis gave the borrower $8,800. The borrower will repay the $10,000 principal at maturity. Willis does not have to recognize any interest income in the current year. |
| III. | A $50,000 two-year loan discounted at 10% is made on July 1. Willis gave the borrower $41,300 on July 1. The borrower will repay the $50,000 principal at maturity. Willis must recognize the interest income annually, using the effective interest method. |
| IV. | A $70,000 two-year loan with interest at 10% is made on July 1. The interest payments on the loan are due annually on July 1, and the principal is due at maturity. Willis has to recognize the interest income of 2 years in the current year. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statements I and III are correct. |
|   | b.  | Only statements I and IV are correct. |
|   | c.  | Only statements II, III, and IV are correct. |
|   | d.  | Only statements II and III are correct. |
|   | e.  | Only statements I and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 113. Franco, the owner and operator of a cleaning service, uses the accrual method of accounting. He receives the following payments on December 31, 2019, the last business day of his tax year:

|  |  |
| --- | --- |
| $5,000 - | Checks are received from customers for services rendered during November and December 2019. The checks are deposited in his bank account on January 4, 2020. |
| $4,000 - | Checks are received from customers for services to be rendered during 2020. The checks are received in the morning mail and deposited in his bank account on December 31, 2019. |
| $2,400 - | A check is received from a customer for a service contract. The services under the contract are to be rendered in 2020. The customer met Franco at the New Year's Eve party and gives Franco the check at 11:30 p.m. The check is deposited in his bank account on January 4, 2020. |

​How much of the $11,400 collected by Franco on December 31 must be included in his 2019 gross income?

|  |  |  |
| --- | --- | --- |
|   | a.  | $5,000 |
|   | b.  | $6,400 |
|   | c.  | $7,400 |
|   | d.  | $9,000 |
|   | e.  | $11,400 |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 114. Brandon, the operator and owner of a cleaning service, uses the cash method of accounting. He receives the following payments on December 31, 2019, the last business day of his tax year:

|  |  |
| --- | --- |
| $3,000 - | Checks are received from customers for services rendered during November and December 2019. The checks are deposited in his bank account on January 4, 2020. |
| $4,000 - | Checks are received from customers for services to be rendered during 2020. The checks are received in the morning mail and deposited in his bank account on December 31, 2019. |
| $2,400 - | A check is received from a customer for a service contract. The services under the contract are to be rendered over 24 months, beginning in January 2020. The customer met Brandon at a New Year's Eve party and gives Brandon the check at 11:30 p.m. The check is deposited in his bank account on January 4, 2020. |

​How much of the $9,400 collected by Brandon on December 31 must be included in his 2019 gross income?

|  |  |  |
| --- | --- | --- |
|   | a.  | $2,400 |
|   | b.  | $3,000 |
|   | c.  | $5,400 |
|   | d.  | $7,000 |
|   | e.  | $9,400 |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 115. Which of the following payments received on December 31, 2019, would be recognized by a cash basis taxpayer in 2019 but would not be recognized in 2019 by an accrual basis taxpayer?

|  |  |
| --- | --- |
| I. | Checks are received from customers for services rendered during November and December 2019. The checks are deposited in the bank account on January 4, 2020. |
| II. | Checks are received from customers for services to be rendered during 2020. The checks are received in the morning mail and deposited in the bank account on December 31, 2019. |
| III. | A check is received from a customer for a service contract. The services under the contract are to be rendered over 24 months, beginning in January 2020. The check is deposited in the bank account on January 4, 2020. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Statements I and II are correct. |
|   | c.  | Only statement III is correct. |
|   | d.  | Statements II and III are correct. |
|   | e.  | Only statement II is correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 116. Chicago Cleaning Services provides nightly janitorial services at a monthly rate of $300. Customers have three payment options:

|  |  |
| --- | --- |
| Month-by-month payments | $300 |
| One-year advance payment | 3,360 ($280 per month) |
| Two-year advance payment | 6,480 ($270 per month) |

If Chicago Cleaning is an accrual basis taxpayer, then:

|  |  |
| --- | --- |
| I. | all cash payments are taxable when they are received. |
| II. | one-year advance payments must be included in income in the year they are received. |
| III. | two-year advance payments are attributable to service in two years and, hence, must be included in income in the year they are received. |
| IV. | one-year advance payments may be deferred: $280 would be included in income for each month of service provided. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Only statement III is correct. |
|   | d.  | Statements II and III are correct. |
|   | e.  | Only statement IV is correct. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 117. Chicago Cleaning Services provides nightly janitorial services at a monthly rate of $300. Customers have three payment options:

|  |  |
| --- | --- |
| Month-by-month payments | $300 |
| One-year advance payment | 3,360 ($280 per month) |
| Two-year advance payment | 6,480 ($270 per month) |

If Chicago Cleaning is a cash basis taxpayer, then:

|  |  |
| --- | --- |
| I. | all cash payments are taxable when they are received. |
| II. | one-year advance payments may be deferred: $280 would be included in income for each month of service provided. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 118. Under the deferral method of accounting for advance receipt of revenues, which of the following statements is/are correct?

|  |  |
| --- | --- |
| I. | Receipts of service revenue collected in advance are included in gross income in the current year to the extent they are included in the revenue for financial accounting purposes. |
| II. | Receipts of rents and interest collected in advance are included in gross income in the current year to the extent they are included in the revenue for financial accounting purposes. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 119. The cash method of accounting for income tax purposes:

|  |  |
| --- | --- |
| I. | is allowed for interest received from Series EE savings bonds. |
| II. | requires a taxpayer who receives services from another taxpayer in exchange for property to include the value of the services in income. |
| III. | is allowed for taxpayers who receive interest income from the issuance of original issue discount securities with a term of more than 1 year. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Only statement III is correct. |
|   | d.  | Statements I and II are correct. |
|   | e.  | Statements I, II, and III are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 120. The accrual method:

|  |  |
| --- | --- |
| I. | is permitted for the advance receipt of rent income. |
| II. | is never permitted under the deferral method. |
| III. | is permitted for the advance receipt of payments for goods to be delivered within the next tax year if the payment is less than the cost of goods sold and the payment is deferred for financial accounting purposes. |
| IV. | is permitted for the advance receipt of interest income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement III is correct. |
|   | c.  | Statements I and II are correct. |
|   | d.  | Statements II and III are correct. |
|   | e.  | Statements II, III, and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 121. Dan is the owner of VHS Video's Inc. VHS rents videos for overnight use and also sells videos from stock. Its gross receipts always exceed $30 million.  In accounting for VHS transactions, Dan:

|  |  |
| --- | --- |
| I. | may use either the cash or the accrual method. |
| II. | must use the cash method to account for video rentals. |
| III. | must use the accrual method for video sales and purchases. |
| IV. | may elect to use the accrual method for all sales and rental revenues and the cash method for purchases of videos and all other business expenses. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Only statement III is correct. |
|   | d.  | Statements II and III are correct. |
|   | e.  | Only statement IV is correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 122. An installment sale:

|  |  |
| --- | --- |
| I. | occurs whenever property is sold and at least one payment is received in a tax year subsequent to the year of sale. |
| II. | may be disregarded by a taxpayer who elects to recognize the entire gain in the year of sale. |
| III. | triggers a method of income recognition based upon the wherewithal-to-pay concept. |
| IV. | allows businesses that sell inventory on credit to defer recognition of income until payment is received. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Statements I and II are correct. |
|   | c.  | Statements I, II, and III are correct. |
|   | d.  | Statements I and IV are correct. |
|   | e.  | Statements II, III, and IV are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 123. The income tax concept that is primarily responsible for the treatment of installment sales of property is the:

|  |  |  |
| --- | --- | --- |
|   | a.  | administrative convenience concept. |
|   | b.  | arm's-length transaction concept. |
|   | c.  | entity concept. |
|   | d.  | realization concept. |
|   | e.  | wherewithal-to-pay concept. |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 124. Pedro sells land that he held as an investment with a basis of $40,000 for $50,000. The terms of the sale require the buyer to pay Pedro $10,000 at the closing of the sale and $20,000 per year for the next 2 years with interest at 7% on the unpaid balance. What is the proper amount of gain to be reported from the sale during each year Pedro receives payments?​     Current         First           Second      Year           Year            Year

|  |  |  |
| --- | --- | --- |
|   | a.  | $2,000          $4,000         $4,000 |
|   | b.  | $10,000        $-0-            $ -0- |
|   | c.  | $ -0-            $4,000         $6,000 |
|   | d.  | $ 3,333        $3,333          $3,334 |
|   | e.  | $-0-            $ -0-            $10,000 |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 125. Southview Construction Company enters into a contract to build a 30-mile cross country ski trail for $36,000 in the current year. Southview estimates the cost of building the trail to be $12,000. During the first year, Southview completes 10 miles of trail at a cost of $5,000. Southview receives $13,000 in advanced payments on the contract price in the first year. How much gross income must Southview recognize from the construction project in the first year?

|  |  |  |
| --- | --- | --- |
|   | a.  | $- 0 - |
|   | b.  | $5,000 |
|   | c.  | $12,000 |
|   | d.  | $13,000 |
|   | e.  | $15,000 |

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 126. Boomtown Construction, Inc. enters into a contract to build a new football stadium for the Maine Lobster's football team. The contract price is $60,000,000, and Boomtown estimates the total cost of the contract to be $50,000,000. During the first year of work on the contract, Boomtown completes 40% of the work on the stadium at a cost of $20,000,000. Boomtown receives $10,000,000 when it signed the contract and an additional $18,000,000 payment in the first year based on the degree of completion. Which of the following statements concerning the income to be recognized from the contract is/are correct?

|  |  |
| --- | --- |
| I. | Boomtown must include the $28,000,000 payment it received in gross income. |
| II. | Because the work is not yet completed, Boomtown has the option of not recognizing any income from the contract. |
| III. | Boomtown includes the $18,000,000 payment in gross income based on the degree of completion because it does not have a claim of right to the $10,000,000. |
| IV. | Boomtown must include $24,000,000 in gross income. |

​

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Statements I and IV are correct. |
|   | c.  | Only statement III is correct. |
|   | d.  | Only statement IV is correct. |
|   | e.  | Statements II and III are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *Match each statement with the correct term below.*

|  |  |
| --- | --- |
| a.  | The category of income that includes interest, dividends, and rents |
| b.  | Income from wages, salaries, and trade or businesses |
| c.  | Interest income resulting from making an interest-free gift loan of $200,000 |
| d.  | A taxable amount received from a state plan to provide a substitute for an employee's earned income |
| e.  | A series of equal payments received over equal time periods |
| f.  | A receipt of cash from a former spouse that is included in gross income |
| g.  | A payment received from a former spouse that is not included in gross income |
| h.  | A division of marital assets that does not result in any income recognition |
| i.  | A sale of property in which at least one payment is received in a tax year after the year of sale |
| j.  | A method of accounting that must be used to recognize income from long-term construction contracts |
| k.  | A debt instrument that has the interest paid at maturity rather than throughout the life of the debt |

 |

|  |  |  |
| --- | --- | --- |
| 127. Alimony

|  |  |
| --- | --- |
| *ANSWER:* | f |

 |

|  |  |  |
| --- | --- | --- |
| 128. Annuity

|  |  |
| --- | --- |
| *ANSWER:* | e |

 |

|  |  |  |
| --- | --- | --- |
| 129. Child-support payment

|  |  |
| --- | --- |
| *ANSWER:* | g |

 |

|  |  |  |
| --- | --- | --- |
| 130. Earned income

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |
| --- | --- | --- |
| 131. Imputed income

|  |  |
| --- | --- |
| *ANSWER:* | c |

 |

|  |  |  |
| --- | --- | --- |
| 132. Installment sale

|  |  |
| --- | --- |
| *ANSWER:* | i |

 |

|  |  |  |
| --- | --- | --- |
| 133. Original issue discount security

|  |  |
| --- | --- |
| *ANSWER:* | k |

 |

|  |  |  |
| --- | --- | --- |
| 134. Percentage-of-completed-contract method

|  |  |
| --- | --- |
| *ANSWER:* | j |

 |

|  |  |  |
| --- | --- | --- |
| 135. Property settlement

|  |  |
| --- | --- |
| *ANSWER:* | h |

 |

|  |  |  |
| --- | --- | --- |
| 136. Unearned income

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |
| --- | --- | --- |
| 137. Unemployment compensation

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |

|  |  |  |
| --- | --- | --- |
| 138. Twenty years ago, Pricilla purchased an annuity costing $19,500 that will pay her $250 per month from age 65 until she dies. Polly is an employee of Evergreen Corporation. During her employment with Evergreen, Polly has paid a total of $20,000 into Evergreen's qualified employee pension plan. Under the plan, Polly is to receive $250 per year from age 65 until she dies. Pricilla and Polly turn 65 during the current year and retire. Each of them has a life expectancy of 12 years from the date of retirement. Discuss the differences in the treatment of the $250 payments each of them receives.

|  |  |
| --- | --- |
| *ANSWER:* | Pricilla has invested $19,500 in her annuity contract and is allowed to recover her investment as she receives the annuity payment. Per the annuity exclusion formula, Pricilla will exclude $75 of each monthly payment and include the remaining $175 in her gross income:          ​Polly is taxed on the entire $250 payment. The $20,000 Polly paid into the Evergreen qualified pension plan reduced her gross salary income (i.e., it was not taxed). Therefore, she has no unrecovered capital investment in the plan and the annuity exclusion formula is not applicable. |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 139. Belina and Harry form B&H Partnership in 2019. Belina contributes $15,000 for a 25% interest in the partnership. Harry contributes a building worth $45,000 for a 75% interest in the partnership. During 2019, B&H reports income of $12,000 from operations. Belina withdraws $6,000 and Harry withdraws $12,000 from the partnership. How much gross income will Belina and Harry report from their investment in B&H and what are their bases in the partnership at the end of 2019?

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* | A partnership is a conduit entity. Belina and Harry must include their respective shares of B&H's income in their gross income. Belina reports $3,000 ($12,000 × 25%) of gross income and Harry reports $9,000 ($12,000 × 75%) of gross income from their investment in B&H. The cash withdrawals are nontaxable recoveries of capital. Belina and Harry must adjust their bases in B&H to reflect the reporting of income that was not received and for cash withdrawals that are not taxed. Belina's basis at the end of 2019 is $12,000 ($15,000 + $3,000 - $6,000). Harry's basis is $42,000 ($45,000 + $9,000 – $12,000).​

|  |  |  |
| --- | --- | --- |
|   | Belina | Harry |
| Cash contributed | $15,000  | $- 0 - |
| Building | - 0 - | 45,000  |
| Share of income | 3,000  | 9,000  |
| Withdrawals | (6,000) | (12,000) |
| End of 2019 basis | $12,000  | $42,000  |

​ |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 140. Amanda, who is single, owns 40% of Sherwood Partnership. During the current year, Sherwood has the following results:

|  |  |
| --- | --- |
| Sales | $380,000 |
| Long-term capital gain | 20,000 |
| Operating expenses | 280,000 |

​

|  |  |
| --- | --- |
| a. | Amanda withdraws $15,000 from the partnership. In addition, Amanda has a $30,000 long-term capital loss from the sale of an investment. What is Amanda's gross income from this information? Explain and show your calculations. |
|   |   |
| b. | Assume that in the next year, Sherwood Publishing has $80,000 of ordinary income and Amanda has a $24,000 short-term capital gain and $20,000 taxable income from other sources. What is her adjusted gross income? Explain and show your calculations. |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* |

|  |  |
| --- | --- |
| a.  | A partnership is a conduit entity that does not pay tax on its income. The owners of conduit entities are taxed on the income of the entity. Because capital gains and losses are subject to a separate netting and treatment than other forms of income, they must be reported separately to each owner. Amanda will have $40,000 [($380,000 - $280,000) × 40%] of ordinary income and an $8,000 ($20,000 × 40%) long-term capital gain from the partnership. The long-term capital gain must be netted with her $30,000 long-term capital loss, resulting in a $22,000 net long-term capital loss for the year. Individuals are allowed to deduct a maximum of $3,000 in capital losses. The $19,000 excess long-term capital loss is carried forward to next year and combined in next year's capital gain and loss netting. The withdrawal of $15,000 is not a taxable transaction, but it does reduce her basis in the partnership. Amanda's income is $37,000: |
|   |  | Ordinary partnership income (40%) | $40,000  |
|   |  | Capital gains netting: |   |
|   |  | Long-term capital gain | $8,000   |
|   |  | Long-term capital loss | (30,000)  |
|   |  | Net long-term capital loss | $(22,000)  |
|   |  | Limited to | (3,000)  |
|   |  | Adjusted gross income | $37,000   |
|   |   |   |   |
| b.  | The $19,000 capital loss carryover from the previous year is netted against the current year $24,000 short-term capital gain, resulting in a $5,000 net short-term capital gain. The short-term capital gain is added to her $20,000 in other taxable income and her $32,000 partnership income. Amanda's adjusted gross income is $57,000: |   |
|   | Taxable income from other sources ​ | $20,000  |
|   | Sherwood Publishing income (40%) ​ | 32,000  |
|   | Capital gains netting: |   |
|   | Long-term capital loss ​ | $(19,000)  |
|   | Short-term capital gain ​ |  24,000   |
|   | Net short-term capital gain ​ | 5,000  |
|   | Adjusted gross income ​ | $57,000  |

​ |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 141. Barrett is a real estate broker. He actively advertises his own and his clients' real estate for sale. He had the following transactions for one segment of his business:

|  |  |
| --- | --- |
| 1/15/08 | Purchased property A for $50,000 |
| 2/15/12 | Paid $10,000 to put up fencing on property A |
| 6/20/12 | Purchased property C for $18,000 |
| 1/15/19 | Sold property C for $23,000 |
| 7/30/19 | Sold property A for $95,000 |

​How should Barrett account for the sales in 2019?

|  |  |
| --- | --- |
| *ANSWER:* | Barrett has a gain on the sale of property A of $35,000 ($95,000 – $50,000 – $10,000) and a gain on the sale of property C of $5,000 ($23,000 – $18,000). The gains are ordinary income because Barrett is a real estate dealer (they are inventory items). Sales of inventory are excluded from capital asset classification. |

 |

|  |  |  |
| --- | --- | --- |
| 142. On December 24 of the current year, Louise is given a certificate by her employer entitling her to $1,500 worth of lodging at a Vail Village resort. The certificate states that it represents a "thank you" for graciously taking care of some client problems that were beyond the scope of normal business activities. The certificate is nontransferable. How much gross income must Louise recognize in the current year due to the certificate? Explain.

|  |  |
| --- | --- |
| *ANSWER:* | If Louise uses the certificate during the current year, she must recognize the value used. Generally, fair market value establishes the amount realized, but since the certificate is nontransferable, it has no market value until used. Realization occurs when the certificate is used rather than the usual situation when something of value is received. |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 143. Arnold is the president of Conrad Corporation. Arnold owns 30% of Conrad, which is organized as an S corporation. Arnold's salary is $100,000. Conrad reports the following for the current year:

|  |  |
| --- | --- |
| Sales | $4,000,000  |
| Cost of goods sold | (1,700,000) |
| Operating expenses | (1,200,000) |
| Salaries (includes Arnold’s salary) | (600,000) |
| Capital loss |   (200,000) |
| Net income | $300,000  |

Conrad Corporation pays $400,000 of dividends. Explain the effect of the information given above on Arnold's adjusted gross income.

|  |  |
| --- | --- |
| *ANSWER:* | S corporations are conduit entities and do not pay tax on their income. Each shareholder must include his/her share of the S corporation's income (loss) in their individual income tax calculation. Dividends received are considered returns of capital investment and do not have any income tax effects. Any income items that are subject to special treatment at the individual level must be separately reported to the shareholders. In this case, capital losses are combined with other capital gains and losses on the individual shareholder's returns to determine the net capital gain or loss for the year. Therefore, each stockholder's share of the capital loss must be reported separately. Arnold will include his $100,000 salary in gross income. His share of the operating income of Conrad, $150,000 [($4,000,000 – $1,700,000 – $1,200,000 – $600,000) × 30%], is also included in his gross income. Arnold also receives a $60,000 ($200,000 × 30%) capital loss that must be combined with any other capital gains and losses he may have to determine his capital gain/loss position for the year. If Arnold has no other capital gains and losses or if the result of the capital gain/loss netting procedure is a loss, he will only be able to deduct $3,000 of the loss.  |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 144. Sarah is single and retires in 2019. During 2019, Sarah's income consists of a $24,000 taxable pension and $10,000 in Social Security benefits.

|  |  |
| --- | --- |
| a. | How much of the Social Security benefits must be included in Sarah's 2019 gross income? |
|   |   |
| b. | If Sarah also receives $7,000 in tax-exempt interest in 2019, how much of the Social Security benefits must be included in her 2019 gross income? |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* |

|  |  |
| --- | --- |
| a. | Sarah will include $2,000 of the Social Security benefits in her 2019 gross income. Because her modified adjusted gross income of $29,000 [$24,000 + (1/2 × $10,000)] is less than $34,000, she is not subject to the second-tier inclusion rule. She includes in gross income: |
|   |
| The lesser of:1/2 × $10,000 = $5,000or1/2 ($24,000 + $5,000 – $25,000) = $2,000 |
|   |   |
| b. | Because Sarah's modified adjusted gross income of $36,000 ($29,000 + $7,000) is greater than $34,000, she is subject to the second-tier inclusion rule for Social Security benefits. She will include $6,200 of the Social Security benefits in gross income: |
|   |
| The lesser of: |
|   |   |
| 1. | 85% × $10,000 = $8,500 |
| or |   |
| 2. | The sum of: |

​

|  |  |  |  |
| --- | --- | --- | --- |
| a. | 85% × ($36,000 – $34,000) = | $1,700 |   |
| b. | The smaller of: |   |   |
|   | I. | $5,000 |   |   |
|   | II. | $4,500 |  4,500 | $6,200 |

​​ |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 145. Explain why the taxpayer in each of the following situations either does or does not have taxable income and determine the amount, if any, that the taxpayer would have to recognize.

|  |  |
| --- | --- |
| a. | On December 1, 2019, Tomlin, a cash basis taxpayer, bills a customer $5,000 for services rendered throughout 2019. The customer comes to Tomlin's office on December 30, 2019, and offers to pay him the $5,000 amount owed. Tomlin suggests that the customer mail the check to him so that he could see how quickly the post office could get the check to him through the mail. The post office delivers the check to Tomlin on January 10, 2020. Tomlin promptly deposits the check in the bank. |
|   |   |
| b. | Patty, age 65, will retire this year. Twenty years ago, she purchased a retirement annuity contract at a cost of $6,000. Under the terms of the contract, Patty is to receive $150 per month for 10 years after reaching age 65. During the current year, Patty receives $1,200 (8 payments). |
|   |   |
| c. | Bud is an accountant for Big Oil Company. In his spare time, Bud collects unique beer cans and bottles. During a party at his house, one of his friends tells him that his can of Billy Beer is a hot item in the professional collector's market. Bud investigates, and instead of selling the Billy Beer, he trades the can of Billy Beer for a bottle of Leinenkugel's beer. |
|   |   |
| d. | Rosemary is awarded the "Outstanding Teaching Award" at DePauw University. She receives a plaque and $3,500. She assigns the $3,500 to DePauw to establish a scholarship for economics majors. |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* |

|  |  |
| --- | --- |
| a. | Tomlin is in constructive receipt of the $5,000 of services income on December 30, 2019. As a cash basis taxpayer, he must include income when it is actually or constructively received. |
|   |   |
| b. | Patty must include $800 of the annuity payments in her gross income. Using the annuity exclusion formula, she excludes $50 of each payment as a return of investment, leaving $100 of each payment taxable as a return on investment: |
|   |   |
|   | Excluded Amount = $6,000 / (12 × 10) = $50 Taxable amount = $150 - $50 = $100 × 8 = $800 |
|   |  |
|   |   |
| c. | Bud has income from the exchange of the beers. He has realized the value of the Billy Beer in an arms-length transaction. He should include in his income the excess of the value of the Leinenkugel's beer over his tax cost of the Billy Beer. |
|   |   |
| d. | Rosemary is not taxed on the award because it was given in recognition of academic achievement. She is not required to perform any future services to receive the award, and she assigned the proceeds to a charitable organization. |

​​ |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 146. Victoria is an employee of Bellamy Corporation. During a recent business trip, one of Victoria's connecting flights was overbooked. Because Victoria did not have a business meeting until the next day, she volunteered to take the next available flight. The airline gave Victoria a $20 meal ticket and a coupon worth $100 off any future flight on the airline for giving up her seat on the overbooked flight. Has Victoria realized income from the receipt of the meal ticket and the coupon? Explain in terms of the income tax concepts.

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* | Under the all-inclusive income concept, all income received is included in gross income. The cash-equivalent approach to income recognition requires recognition of income when anything of value is received as income. To have income, the taxpayer's wealth must have increased and the increase in wealth must be realized. A realization consists of a change in the form and/or substance of the taxpayer's property or property in an arm's-length transaction.Based on the income tax concepts, the following issues should be addressed:

|  |  |
| --- | --- |
| I. | Did Victoria's wealth increase? On the surface, it appears that her wealth has increased by the $120 she does not have to spend on meals and a future airline flight. However, the $120 is more likely a rebate of the cost of her original ticket. The airline is reducing the cost of the original flight because it was unable to honor the conditions of the flight. If this is the case, any deductions for meals and the flight will have to be reduced accordingly. |
|   |   |
| II. | Did a realization occur? Although an arm's-length transaction occurred, it could be argued that Victoria's property (her current ticket) did not change its form. She still has a ticket to her destination. There is no guarantee that either the meal ticket or the coupon will be used. Thus, one could argue that no realization occurs until she actually uses the ticket and the coupon. |
|   |   |
| III. | Even if all the criteria for realization are met, will it have to be recognized? Due to the complexity of tracking these small amounts of income, the income will be excluded based on the administrative convenience concept. |

 |

 |

|  |  |  |
| --- | --- | --- |
| 147. Melissa is currently working with her divorce attorney on her impending divorce from her husband David. She recently discovered that she is pregnant with David's child. Melissa intends to keep and raise the child. David's attorney has submitted a proposal that David pay Melissa alimony of $1,500 per month. The proposed alimony contract satisfies the IRS tests for alimony. As a tax planner, what advice do you have for Melissa? Is there a way to structure the payments to minimize Melissa's income taxes?

|  |  |
| --- | --- |
| *ANSWER:* | If the divorce agreement is finalized in 2019 or earlier, then the alimony received is taxable to Melissa. If the payments were child support, they would not be taxable income to Melissa. (Furthermore, collection of child support is more likely to be enforced by the family law courts than is alimony.)​On the other hand, David is likely to pay a greater amount of alimony because it is deductible to him. If Melissa is in a very low tax bracket, the additional tax she may pay will be less than what David will save.​She should probably ask for more alimony and split the economic gain from having more money taxed at her lower rate.​If the divorce agreement is finalized in 2020, then Melissa has no gross income whether or not the payments are alimony or child support. |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 148. Explain why the taxpayer in each of the following situations either does or does not have taxable income and determine the amount, if any, that the taxpayer would have to recognize.

|  |  |
| --- | --- |
| a. | Rafael works as a salesman of Dependable Cars Inc. Because Rafael is the year's top salesman, Dependable Cars allows Rafael to purchase a car for $30,000, which normally sells for $35,000 (Dependable Car's cost was $28,000). |
|   |   |
| b. | Janine's brother Barry is laid off from his job for the first half of the year. Because Barry is having trouble paying all of his bills, Janine tells Barry that she will help him out and pay the property taxes on Barry's house. The property taxes amount to $1,000. |
|   |   |
| c. | Thomas works as a production manager for Healthy Body, Inc. Because Thomas's unit had not had a work-related accident for 2 years, Healthy Body gives Thomas a weight machine that was worth $500. |
|   |   |
| d. | Emmett was out for his daily walk when he spots an old shirt on the side of the road. Upon inspection, he determines it to be an old baseball uniform, which is in good condition. So he takes it home and washes it. At a party 2 months later, Mark, a baseball memorabilia collector, tells him that it might be worth something. Emmett takes the shirt down to the local collector's shop where he learns that the shirt was once worn by Willie Mays and is worth at least $7,000. |
|   |   |
| e. | Helen invests $10,000 for a 25% interest in Lockport Landscaping, an S corporation, on January 1, 2019. During 2019, Lockport pays Helen $45,000 in wages for her services as the general manager and $2,000 in cash dividends on her stock. Lockport reports a 2019 net income of $80,000. |
|   |   |
| f. | Amber wins $10,000 in the state lottery from a ticket given to her by her cousin, Beverly. |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* |

|  |  |
| --- | --- |
| a. | Rafael has an income of $5,000 from the purchase of the car below its normal selling price. This is compensation for being the top salesman and constitutes a taxable bargain purchase. It cannot be excluded as an employee discount on goods because all employees are not allowed to purchase cars at similar discounts. |
|   |   |
| b. | Barry does not have taxable income from the payment of his property taxes by Janine. There is no intent to compensate. Because they are brother and sister, the payment would be characterized as an excludable gift. |
|   |   |
| c. | Employee awards of tangible property for length of service and safety achievements are excluded from tax. The general exclusion amount is limited to $400. However, if the award is part of a qualified plan, up to $1,600 can be excluded. Thomas will have an income of $100 if Healthy Body does not have a qualified plan and will report no income from the award if Healthy Body does have a qualified plan. |
|   |   |
| d. | Emmett's wealth increased due to a "treasure trove." However, no realization has occurred. Emmett has no wherewithal to pay tax on the wealth increase. Realization and recognition will occur when Emmett sells or exchanges the shirt. |
|   |   |
| e. | Helen has a gross income of $65,000. Because Lockport is a conduit entity, Helen must include her share of Lockport's income, $20,000 ($80,000 × 25%), in her income. The cash dividends she received are nontaxable recoveries of capital. Because Lockport is a corporation that is a separate entity, Helen can be an employee of the corporation and she is taxed on the $45,000 of wages she receives. |
|   |   |
| f. | Amber's gross income is $10,000. The gift of the ticket merely transfers the ownership of the ticket. There is no exclusion (legislative grace) for lottery winnings or prizes. All-inclusive income concept is applied. |

​ |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 149. On January 1 of the current year, Beverly borrows $100,000 from her employer, Happy Hills Nursing Home. Beverly uses this loan to pay off credit cards and consumer loans. Happy Hills considers Beverly to be a loyal employee and allows her up to 5 years to repay the loan. Beverly is not a shareholder or officer in Happy Hills. Happy Hills does not charge any interest on the loan. Both Happy Hills and Beverly are on a December 31 fiscal year end. What is the income tax issue for Happy Hills? You do not need to do any calculations.

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* | At least one of the following should be discussed:

|  |  |
| --- | --- |
| • | Imputed interest rules |
| • | Below-market rate loans |
| • | Employment-related loans |
| • | Arm's-length transaction concept |
| • | The amount of imputed interest is compensation income to Beverly and deductible compensation expense for Happy Hills. |

 |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 150. Stephanie and Matt are married with no children. During 2019, they have a total gross income of $140,000. Their allowable deductions for adjusted gross income total $6,000 and they have $16,000 of allowable itemized deductions. Compute Stephanie and Matt's 2019 taxable income and 2019 income tax liability.

|  |  |
| --- | --- |
| a. | Assume that in addition to the information given above, Stephanie sold some land that she had held as an investment at a gain of $5,000. What is the effect of the gain on their taxable income and income tax liability? You do not need to recalculate; just explain the general effect of the sale of the land. |
|   |   |
| b. | Assume the same facts as in part (a) and that Matt also sold some stock he purchased several years ago at a $12,000 loss. What is the effect of the gain on the land and the loss on the stock on their taxable income? Explain. |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* | Stephanie and Matt have a taxable income of $109,600. Their tax liability on $109,600 is $15,829 [$9,086 + 22% × ($109,600 – $78,950)].​

|  |  |
| --- | --- |
| Gross income | $140,000  |
| Deductions for AGI |  (6,000) |
| AGI | $134,000  |
| Deductions from AGI (Standard deduction) | (24,400) |
| Taxable income | $109,600 |

​

|  |  |
| --- | --- |
| a. | The gain on the sale of the land is a capital gain. The capital gain is included in their gross income, increasing taxable income by $5,000. The effect on their tax liability depends on whether the gain is short term or long term. If the gain is short term, the $5,000 will be taxed at their 22% marginal tax rate. If the gain is long term, it will be taxed at the 15% long-term capital gains rate. Therefore, their tax liability will increase by $1,100 ($5,000 × 22%) if the gain is short term or by $750 ($5,000 × 15%) if it is long term. |
|   |   |
| b. | The loss on the sale of the stock is a capital loss. To determine the tax effect of the loss, it must be netted against other capital gains. This results in a net capital loss of $7,000 ($5,000 gain – $12,000 loss). Capital losses are deductible but are limited to $3,000 per year. Stephanie and Matt's taxable income will decrease by the $3,000 capital loss deduction. The remaining $4,000 of net capital loss is carried forward to 2020. The $3,000 capital loss deduction in 2019 reduces their tax liability by $660 ($3,000 × 22%). |

 |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 151. In 2006, Force Partnership purchased an apartment building for $600,000 and paid an additional $10,000 in acquisition fees. The partnership properly claimed $130,000 in depreciation on the building. In 2019, Force allows the building to be foreclosed by the bank for $490,000, the amount of the outstanding loan principal. What is the realized gain or loss, if any, for the partnership resulting from the foreclosure?

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* | Force has realized income from the foreclosure. An increase in the partnership's wealth has occurred in an arm's-length transaction. Force's realized gain is $10,000:

|  |  |
| --- | --- |
| Amount realized - debt forgiven | $490,000  |
| Adjusted basis |   |
| Cost | $600,000  |
| Acquisition fees | 10,000  |
| Cost recovery | (130,000) |
| Adjusted basis | 480,000  |
| Realized gain | $10,000  |

Note: The realized gain will be allocated to the partners and taxed on the partners' individual income tax returns. |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 152. Cathy, an attorney, bills a client $12,000 for services rendered in November 2019. The client is having cash flow problems and Cathy accepts 1,000 shares of Petrol Corporation common stock in full satisfaction of the account on July 5, 2020. On July 5, 2020, the Petrol stock is selling for $10 per share. Cathy sells the Petrol stock on August 10, 2020, for $11 per share. What is the effect of the transactions on Cathy's 2020 taxable income if:

|  |  |
| --- | --- |
| a. | Cathy is a cash basis taxpayer? |
|   |   |
| b. | Cathy is an accrual basis taxpayer? |

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* |

|  |  |
| --- | --- |
| a. | Cash basis taxpayers recognize income when it is received. Cathy will recognize the $10,000 value of the stock as income when the stock is received in 2020. Because she has included the $10,000 in her income, the stock's basis becomes $10,000. She will recognize a short-term capital gain of $1,000 ($11,000 – $10,000) from the sale of the stock in 2020. |
|   |   |
| b. | Cathy will recognize $12,000 of income from services in 2019. When she accepts full settlement of the account in 2020 for $10,000 worth of stock, she will deduct $2,000 as a business bad debt. The stock will have a basis of $10,000 and she will recognize a short-term capital gain of $1,000 from the sale of the stock in 2020. |

​​ |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 153. Determine the amount of gross income the taxpayer must report in each of the following situations. Explain why the amount is taxable and how you determined the taxable amount.

|  |  |
| --- | --- |
| a. | Marlon purchased an annuity costing $13,000 that will pay him $300 per month for life upon reaching age 65. In 2019, when his life expectancy is 14 years, Marlon turns 65 and begins receiving the annuity payments. In 2019, Marlon receives $1,800 (6 payments) from the annuity. |
|   |   |
| b. | Fargo Systems Corporation, an accrual basis taxpayer, leases computer time on its mainframe computer. In November 2019, Fargo enters into a two-year lease with Bismarck Processing, Inc. The lease agreement requires Bismarck to pay a $4,800 fixed fee when the lease is signed and $100 per hour of mainframe use, paid on a monthly basis. Fargo receives the $4,800 payment on November 1, 2019. Bismarck pays Fargo $800 on December 15, 2019, for November computer use and $1,200 on January 18, 2020, for December computer use. |
|   |   |
| c. | Maria, a single taxpayer, is retired. During the current year, she receives $19,000 from her employer's qualified pension plan, $1,000 in interest on a savings account, $30,000 in interest on tax-exempt municipal bonds, and $10,000 in Social Security benefits. |
|   |   |
| d. | Stuart works for Prairie Surveyors of Kansas. During the current year, Prairie Surveyors replaces all of its computer equipment. Stuart makes a deal with his boss to purchase one of the old computers for $200. Prairie Surveyors received a $1,000 trade-in allowance on the other computers it replaced. |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* | ​

|  |  |
| --- | --- |
|  a. |  Marlon has $1,500 ($250 × 6) of gross income from the annuity in 2019. Under the capital recovery concept, Marlon is allowed to recover his $13,000 investment in the annuity contract; only the returns on the investment are taxable. Marlon excludes $50 ($13,000 ÷ 260 months from Table 3-1) of each payment and includes $250 of each payment ($300 - $50) in his gross income. |
|   |   |
|  b. |  Fargo must include $2,400 [($4,800 × 2/24) + $800 + $1,200] in its 2019 gross income. Under the wherewithal-to-pay concept, prepaid income received by accrual basis taxpayers is included in income in year of receipt, unless the deferral method applies. The deferral method applies to the $4,800 fixed fee because the contract is for service. So Fargo must include the amount earned (2/24) in 2019 and the remaining part (22/24) in 2020. The $800 and $1,200 mainframe use are included in income as they are earned (not when they are received) under the accrual method of accounting. |
|   |   |
|  c. |  Maria's gross income is $28,500 ($19,000 + $1,000 + $8,500). The pension plan payment is included in income because the amounts in a qualified plan are taxed, as they are withdrawn. The interest on the tax-exempt bonds is excluded from gross income. Mara must include $8,500 of the Social Security benefits (the maximum) in her gross income. Her modified adjusted gross is $55,000 ($19,000 + $1,000 + $5,000 + $30,000), which is above the $34,000 base amount for the second-tier inclusion rule. She must include the lesser of: |
|   |   |
|   |  1. |   85% × ($10,000) |  = | $8,500 |
|   |   |  or |   |   |
|   |  2. |  85% × ($55,000 – $34,000) |  = | $17,850  |
|   |   |  Plus: Lesser of $4,500 or $5,000 |   | 4,500  |
|   |   |  Equals |   | $22,350  |
|   |   |
|  d. |  This is a bargain purchase. Because Stuart is able to buy the computer for $800 ($1,000 - $200) less than what others paid for the same computer, he is receiving a benefit from his employer. Stuart must include $800 in gross income. |

 |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 154. Determine the amount of income that must be recognized by the taxpayer(s) in the current year for each of the following situations. Explain how you determined the amount that was taxable.

|  |  |
| --- | --- |
| a. | Tien sells a parcel of land she held as an investment for $50,000. Tien purchased the land 4 years ago for $28,000. She spent $2,000 grading the land and $6,000 putting in utility lines. Tien receives $16,000 upon closing the sale. The remaining $40,000 is to be received in four annual payments of $10,000 over the next 4 years, with interest at 8% on the outstanding balance. |
|   |   |
| b. | Randy receives a $10,000, 6%, bond from his grandfather, Kenneth, for his birthday on September 30. Annual interest is paid on December 31. Randy receives the $600 payment on December 31. |
|   |   |
| c. | David is an employee of Fern Leaf Company. David is robbed and knocked unconscious while coming out of a basketball game on December 29. His $550 paycheck is available to be picked up at Fern Leaf on December 30, but David does not regain consciousness until January 3. He picks up the check and deposits it on January 8. |
|   |   |
| d. | Angie was shopping at a "flea market" when she saw a painting with a frame that appeared to be quite old. Although the painting was uninteresting, she paid the $35 asking price just to get the frame. When she returned home, she took the old painting out of the frame, intending to throw it away. However, she noticed what appeared to be another painting behind the one she bought. Curious, she took the painting to a friend who is a local art expert. The friend thought the second painting was a lost "Monet" and could be worth millions. Angie sends the painting to a museum in Boston, which confirms that the painting is indeed a lost "Monet." Similar paintings have been selling for $650,000 to $800,000, although the art market is in a down cycle. Angie decides to wait until the art market picks up a bit to sell the painting. |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* |

|  |  |
| --- | --- |
| a. | $14,000 ($50,000 – $36,000) gain is realized. $4,480 [($16,000 ÷ $50,000) × $14,000] gain is recognized since it is an installment sale. Wherewithal to pay concept is applied. |
|   |   |
| b. | Randy becomes the owner of the bond on September 30. The receipt of the bond is excluded from gross income because it is a gift. However, Kenneth must recognize the interest income earned on the bond prior to the gift, $450 [$10,000 × 6% × (9 ÷ 12)]. Randy recognizes $150 of interest (September 30 to December 31). |
|   |   |
| c. | David must recognize the $550 in the year the check was written. The funds were available to David. Someone else could have deposited the check for him. David constructively received the $550 because he had knowledge that the check was available on December 30. |
|   |   |
| d. | Angie has discovered a "treasure trove." However, no realization has occurred. Angie has no wherewithal to pay tax on the wealth increase. Realization and recognition will occur when Angie sells or exchanges the artwork. |

​ |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 155. Determine the amount of gross income the taxpayer must report in each of the following situations. Explain why the amount is taxable and how you determined the taxable amount.

|  |  |
| --- | --- |
| a. | National Corporation receives a $12,000 bill for legal fees from its attorney in December. National paid the bill promptly and deducted the $12,000 as a legal expense for its year ending December 31. During the audit of its financial statements, the auditor determines that the attorney had double billed the corporation for $3,000 of expenses. National sent a copy of the auditor's findings in March. The attorney agrees with the auditor and sends National a check for $3,000 in April. |
|   |   |
| b. | Greta spends a week in Las Vegas. While cashing in some of her chips at the cashier's window, she looks down and sees a $1,000 bill lying crumpled on the floor. She picks up the bill and puts it in her pocket. |
|   |   |
| c. | Akron Living, Inc., an accrual basis corporation, owns an apartment building. On November 1, it rents an apartment for $400 per month. Per the terms of the rental agreement, the tenant pays the corporation $1,100 on November. The $1,100 consists of the first and last months' rent and a $300 cleaning deposit. The cleaning deposit will be used at the end of the lease and any amount not used for cleaning will be returned to the tenant. Very little is usually returned. |
|   |   |
| d. | Anthony is an employee of Channel Company. Channel Company institutes a computer upgrade and offers its old computers for sale for $700. Anthony offers Channel $500 for one of the computers. Because they have not been selling well, Channel accepts Anthony's offer and sells him a computer for $500. |
|   |   |
| e. | James owns Argyle Co. as a sole proprietorship. In November, James pays a $600 bill for supplies and deducts it on his tax return. The following February, the supplier sends James a check for $120. A letter accompanying the check indicated that the supplier had overcharged Argyle Co. and the check was to adjust for the overcharge. |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *ANSWER:* |

|  |  |
| --- | --- |
| a. | National recognizes $3,000 of income in April. Under the tax benefit rule, any deduction that is recovered in a subsequent period is income in the recovery period to the extent that a tax benefit was received from the deduction. Because National has previously deducted the $3,000 over billing, it must include it in income when it receives repayment. Under the annual accounting period concept, you do not go back and restate the prior year's deduction. |
|   |   |
| b. | Greta has a claim of right to the $1,000. She has to include the $1,000 in her gross income. There is no legislative grace that permits exclusion of cash treasure troves. |
|   |   |
| c. | The first and last months' rent ($800) are taxable per the wherewithal-to-pay concept, which overrides the accrual basis for recognizing prepaid income. The $300 cleaning deposit is not taxable because Akron Living does not have a claim of right to the deposit when it is received. |
|   |   |
| d. | Anthony is not taxed on the purchase of the computer. This is not a bargain purchase because the price was determined at arm's length. Anthony offered less than the $700 advertised price and Channel accepted the offer because the computers had not been selling well. |
|   |   |
| e. | Argyle Co. must include the $120 in gross income. Because Argyle deducted the $120 in the previous year, the $120 is included in gross income under the tax benefit rule. The annual accounting period concept does not allow Argyle Co. to go back and amend the previous year's deduction. |

 |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 156. Which of the following statements is/are correct?

|  |  |
| --- | --- |
| I. | Belle is retired. Her only sources of income are her $1,500 per month pension and $12,000 of Social Security benefits. Belle must include $6,000 of the Social Security benefits in her gross income. |
| II. | Eileen and Daren divorce during the current year. Per the divorce agreement, Daren is to receive alimony of $600 per month, $400 per month for child support, and the family house that is valued at $200,000. Daren must recognize $600 per month as income. |

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Both statements are correct. |
|   | d.  | None of the statements are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | b |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 157. After buying books at the beginning of the semester, Iris finds a $50 bill outside the door of the bookstore. The $50 is considered gross income. Which of the following constructs supports this treatment?

|  |  |  |
| --- | --- | --- |
|   | a.  | All-inclusive income concept |
|   | b.  | Capital recovery concept |
|   | c.  | Wherewithal-to-pay concept |
|   | d.  | Administrative convenience concept |
|   | e.  | Constructive receipt doctrine |

|  |  |
| --- | --- |
| *ANSWER:* | a |

 |

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| 158. After buying a new sofa at the furniture store, Hilda finds a $1,000 bill in the parking lot near her car. What are the tax effects of this find?

|  |  |
| --- | --- |
| I. | Hilda must recognize $1,000 of income in the current tax year. |
| II. | The all-inclusive income concept applies in this situation. |
| III. | Hilda will not recognize the $1,000 because the IRS will never know about the windfall. |
| IV. | Hilda will not recognize the $1,000 because there is not a specific tax law provision requiring it. |

|  |  |  |
| --- | --- | --- |
|   | a.  | Only statement I is correct. |
|   | b.  | Only statement II is correct. |
|   | c.  | Only statement IV is correct. |
|   | d.  | Statements I and II are correct. |
|   | e.  | Statements II and III are correct. |

|  |  |
| --- | --- |
| *ANSWER:* | d |

 |