

1. The FICA tax (Medicare component) on wages is *progressive* since the tax due increases as wages increase.

- a. True
- b. False

ANSWER: False

RATIONALE: The FICA tax (Medicare component) is *proportional* because the rate is constant regardless of the wages earned.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-01 - LO: 1-01

ES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

2. The Federal estate and gift taxes are examples of *progressive* taxes.

- a. True
- b. False

ANSWER: True

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-01 - LO: 1-01

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

3. The Federal excise tax on cigarettes is an example of a *proportional* tax.

- a. True
- b. False

ANSWER: True

RATIONALE: The tax is a flat \$1.01 per pack.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-01 - LO: 1-01

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
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KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

4. Currently, the Federal income tax is less *progressive* than it ever has been in the past.

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- a. True
- b. False

ANSWER: False

RATIONALE: Currently, the Federal income tax has six rates. At one time, it had two rates.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-01 - LO: 1-01

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

5. Mona inherits her mother's personal residence, which she converts to a furnished rental house. These changes should affect the amount of *ad valorem* property taxes levied on the properties.

- a. True
- b. False

ANSWER: True

RATIONALE: Conversion from residential to rental use will increase the taxes. Furthermore, Mona's mother may have had a senior citizen exemption on the property, which will no longer be appropriate. Lastly, the furnishings in the rent house could now be subject to an *ad valorem* tax on personalty.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

6. A *fixture* will be subject to the *ad valorem* tax on *personalty* rather than the *ad valorem* tax on *realty*.

- a. True
- b. False

ANSWER: False

RATIONALE: By definition, a fixture becomes part of the real estate to which it is attached.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

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7. Even if property tax rates are not changed, the amount of *ad valorem* taxes imposed on realty may not remain the same.

- a. True
- b. False

ANSWER: True

RATIONALE: Property taxes will vary in accordance with changes in the assessed value of the property.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

8. The *ad valorem* tax on personal use personalty is more often avoided by taxpayers than the *ad valorem* tax on business use personalty.

- a. True
- b. False

ANSWER: True

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

9. A Federal excise tax is no longer imposed on admission to theaters.

- a. True
- b. False

ANSWER: True

RATIONALE: Such tax has been rescinded.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

10. There is a Federal excise tax on hotel occupancy.

- a. True
- b. False

ANSWER: False

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POINTS: 1
DIFFICULTY: Easy
LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02
NATIONAL STANDARDS: United States - BUSPORG: Analytic
STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement
KEYWORDS: Bloom's: Knowledge
OTHER: Time: 2 min.

11. The Federal gas-guzzler tax applies only to automobiles manufactured overseas and imported into the U.S.

- a. True
- b. False

ANSWER: False

RATIONALE: No such restriction is imposed. Although many of the European luxury and sports car manufacturers were initially hit hard by the tax, the law is silent on this matter.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

12. Like the Federal counterpart, the amount of the state excise taxes on gasoline varies from state to state.

- a. True
- b. False

ANSWER: False

RATIONALE: The Federal excise tax rate on gasoline remains constant.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

13. Not all of the states that impose a general sales tax also have a use tax.

- a. True
- b. False

ANSWER: False

RATIONALE: Every state that has a general sales tax also has a use tax. There are no states with only a sales or use tax.

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POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVE EOTX.SWFT.LO: 1-02 - LO: 1-02

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STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

14. Sales made by mail order are not exempt from the application of a general sales (or use) tax.

a. True

b. False

ANSWER: True

RATIONALE: They are not exempt but compliance is sporadic.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

15. Two persons who live in the same state but in different counties may not be subject to the same general sales tax rate.

a. True

b. False

ANSWER: True

RATIONALE: This possibility could exist if local jurisdictions exact additional sales taxes.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

16. States impose either a state income tax *or* a general sales tax, but not both types of taxes.

a. True

b. False

ANSWER: False

RATIONALE: Many states impose both.

POINTS: 1

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<i>DIFFICULTY:</i>	Easy
<i>LEARNING OBJECTIVES:</i>	EOTX.SWFT.LO: 1-02 - LO: 1-02
<i>NATIONAL STANDARDS:</i>	United States - BUSPORG: Analytic
<i>STATE STANDARDS:</i>	United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
<i>KEYWORDS:</i>	Bloom's: Knowledge
<i>OTHER:</i>	Time: 2 min.

17. A safe and easy way for a taxpayer to avoid local and state sales taxes is to make the purchase in a state that levies no such taxes.

- a. True
- b. False

<i>ANSWER:</i>	False
<i>RATIONALE:</i>	A review of the Example 5 discussion shows that this may not always be successful.
<i>POINTS:</i>	1
<i>DIFFICULTY:</i>	Easy
<i>LEARNING OBJECTIVES:</i>	EOTX.SWFT.LO: 1-02 - LO: 1-02
<i>NATIONAL STANDARDS:</i>	United States - BUSPORG: Analytic
<i>STATE STANDARDS:</i>	United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
<i>KEYWORDS:</i>	Bloom's: Comprehension
<i>OTHER:</i>	Time: 2 min.

18. On transfers by death, the Federal government relies on an estate tax, while states impose an estate tax, an inheritance tax, both taxes, or neither tax.

- a. True
- b. False

<i>ANSWER:</i>	True
<i>RATIONALE:</i>	The Federal government relies on an estate tax while states impose an estate tax, an inheritance tax, both taxes, or neither tax.
<i>POINTS:</i>	1
<i>DIFFICULTY:</i>	Easy
<i>LEARNING OBJECTIVES:</i>	EOTX.SWFT.LO: 1-02 - LO: 1-02
<i>NATIONAL STANDARDS:</i>	United States - BUSPORG: Analytic
<i>STATE STANDARDS:</i>	United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement
<i>KEYWORDS:</i>	Bloom's: Knowledge
<i>OTHER:</i>	Time: 2 min.

19. An inheritance tax is a tax on a decedent's right to pass property at death.

- a. True
- b. False

<i>ANSWER:</i>	False
<i>RATIONALE:</i>	What is described is an estate tax. An inheritance tax is a tax on an heir's right to receive property

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from a decedent.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

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AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

20. One of the major reasons for the enactment of the Federal estate tax was to prevent large amounts of wealth from being accumulated within the family unit.

- a. True
- b. False

ANSWER: True

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

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AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

21. Under Clint's will, all of his property passes to either the Lutheran Church or to his wife. No Federal estate tax will be due on Clint's death in 2016.

- a. True
- b. False

ANSWER: True

RATIONALE: A combination of the charitable and marital deductions will eliminate Clint's taxable estate.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPROG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

22. Under the usual state inheritance tax, two heirs, a cousin and a son of the deceased, would not be taxed at the same rate.

- a. True
- b. False

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ANSWER: True

RATIONALE: The more closely related the heir is to the decedent, the larger the exemption allowed and/or the lower the tax rate imposed.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

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NATIONAL STANDARDS: United States - BUSPORG: Analytic

RDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

23. The annual exclusion, currently \$14,000, is available for gift and estate tax purposes.

- a. True
- b. False

ANSWER: False

RATIONALE: The annual exclusion is not available for estate tax purposes.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

24. In 2016, José, a widower, sells land (fair market value of \$100,000) to his daughter, Linda, for \$50,000. José has not made a taxable gift.

- a. True
- b. False

ANSWER: False

RATIONALE: \$100,000 (value of land) – \$50,000 (consideration received) – \$14,000 (per donee annual exclusion) = \$36,000 (taxable gift).

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

VES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

RDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 5 min.

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25. Julius, a married taxpayer, makes gifts to each of his six children. A maximum of twelve annual exclusions could be allowed as to these gifts.

- a. True
- b. False

ANSWER: True

RATIONALE: If Julius can obtain the consent of his wife to make the election to split the gifts, twelve per donee annual exclusions are available.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS:

United States - BUSPORG: Analytic
RDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
: AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

26. One of the motivations for making a gift is to save on income taxes.

- a. True
- b. False

ANSWER: True

RATIONALE: This presumes that income-producing property is involved and that the donee is in a lower tax bracket than the donor.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS:

United States - BUSPORG: Analytic
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STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

27. The formula for the Federal income tax on corporations is the same as that applicable to individuals.

- a. True
- b. False

ANSWER: False

RATIONALE: For example, an AGI determination is required only for individual taxpayers.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

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KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

28. The principal objective of the FUTA tax is to provide some measure of retirement security.

- a. True
- b. False

ANSWER: False

RATIONALE: This is the objective of the FICA tax.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

29. Currently, the tax base for the Social Security component of the FICA is *not* limited to a dollar amount.

- a. True
- b. False

ANSWER: False

RATIONALE: There is no dollar amount limitation on the Medicare component of FICA.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 2 min.

30. A parent employs his twin daughters, age 17, in his sole proprietorship. The daughters are *not* subject to FICA coverage.

- a. True
- b. False

ANSWER: True

RATIONALE: An exemption exists for taxpayer's children who are *under age 18*.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

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31. Unlike FICA, FUTA requires that employers comply with state as well as Federal rules.

- a. True
- b. False

ANSWER: True

RATIONALE: This is a major difference between FICA and FUTA.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

32. When Congress enacts a tax cut that is phased in over a period of years, revenue neutrality is achieved.

- a. True
- b. False

ANSWER: False

RATIONALE: No tax cut is revenue neutral unless accompanied by a revenue offset. A phase-in merely postpones some of the revenue loss caused by the tax cut.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

33. A tax cut enacted by Congress that contains a *sunset provision* will make the tax cut temporary.

- a. True
- b. False

ANSWER: True

RATIONALE: The sunset provision rescinds the change and reinstates former law.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

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34. The tax law provides various tax credits, deductions, and exclusions that are designed to encourage taxpayers to obtain additional education. These provisions can be justified on both economic and equity grounds.

- a. True
- b. False

ANSWER: False

RATIONALE: The justification is social and economic.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

35. Various tax provisions encourage the creation of certain types of retirement plans. Such provisions can be justified on both economic and social grounds.

- a. True
- b. False

ANSWER: True

RATIONALE: Economic and social grounds. The economic justification is attributable to the savings that result. In terms of social justification, private retirement plans supplement the meager benefits provided by Social Security and, thereby, circumvent the need for public assistance.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

CTIVES:

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

36. To lessen, or eliminate, the effect of multiple taxation, a taxpayer who is subject to both foreign and U.S. income taxes on the same income is allowed either a deduction or a credit for the foreign tax paid.

- a. True
- b. False

ANSWER: True

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS: United States - BUSPROG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

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OTHER:

Time: 2 min.

37. To mitigate the effect of the annual accounting period concept, the tax law permits the carryforward to other years of the excess charitable contributions of a particular year.

- a. True
- b. False

ANSWER:

True

RATIONALE:

This is also the case with excess capital losses.

POINTS:

1

DIFFICULTY:

Easy

LEARNING OBJECTIVES:

EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS:

United States - BUSPORG: Analytic

STATE STANDARDS:

United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS:

Bloom's: Comprehension

OTHER:

Time: 2 min.

38. Jason's business warehouse is destroyed by fire. As the insurance proceeds exceed the basis of the property, a gain results. If Jason shortly reinvests the proceeds in a new warehouse, no gain is recognized due to the application of the wherewithal to pay concept.

- a. True
- b. False

ANSWER:

True

POINTS:

1

DIFFICULTY:

Moderate

LEARNING OBJECTIVES:

EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS:

United States - BUSPORG: Analytic

STATE STANDARDS:

United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS:

Bloom's: Comprehension

OTHER:

Time: 2 min.

39. As it is consistent with the wherewithal to pay concept, the tax law requires a seller to recognize gain in the year the installment sale occurs.

- a. True
- b. False

ANSWER:

False

RATIONALE:

The seller is taxed in the years the installment payments are received.

POINTS:

1

DIFFICULTY:

Easy

LEARNING OBJECTIVES:

EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS:

United States - BUSPORG: Analytic

STATE STANDARDS:

United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS:

Bloom's: Comprehension

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40. A provision in the law that compels accrual basis taxpayers to pay a tax on prepaid income in the year received and *not* when earned is consistent with generally accepted accounting principles.

- a. True
- b. False

ANSWER: False

RATIONALE: It is inconsistent with accounting rules, although it can be justified for tax purposes under the wherewithal to pay concept.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

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NATIONAL STANDARDS: United States - BUSPROG: Communications
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STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

41. As a matter of administrative convenience, the IRS would prefer to have Congress decrease (rather than increase) the amount of the standard deduction allowed to individual taxpayers.

- a. True
- b. False

ANSWER: False

RATIONALE: Just the opposite is the case.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-07 - LO: 1-07

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Research

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

42. Which, if any, of the following transactions will *increase* a taxing jurisdiction's revenue from the *ad valorem* tax imposed on real estate?

- a. A resident dies and leaves his farm to his church.
- b. A large property owner issues a conservation easement as to some of her land.
- c. A tax holiday issued 10 years ago has expired.
- d. A bankrupt motel is acquired by the Red Cross and is to be used to provide housing for homeless persons.
- e. None of these.

ANSWER: c

RATIONALE: Although a farm was probably subject to reduced valuation (due to its agricultural use), it will now be fully exempt since it is owned by a church (choice a.). Property that is subject to a conservation easement is usually appraised at a lower value (choice b.). The expiration of a tax holiday means that the property involved can now be taxed (choice c.). The motel has been converted from business property to exempt charitable use (choice d.).

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POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: SWFT.LO: 1-02 - LO: 1-02

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 5 min.

43. Which, if any, of the following transactions will *decrease* a taxing jurisdiction's *ad valorem* tax revenue imposed on real estate?

- a. A tax holiday is granted to an out-of-state business that is searching for a new factory site.
- b. An abandoned church is converted to a restaurant.
- c. A public school is razed and turned into a city park.
- d. A local university sells a dormitory that will be converted for use as an apartment building.
- e. None of these.

ANSWER: a

RATIONALE: Choice a. has an effect since the tax holiday was granted. Choice b. will increase taxes as the church was abandoned and previously exempt. Choice c. converts one tax-exempt property (i.e., school) into another (i.e., public park). Choice d. probably places the building on the tax rolls because it is no longer owned by a tax-exempt institution.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: SWFT.LO: 1-02 - LO: 1-02

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 5 min.

44. Which, if any, of the following is a typical characteristic of an *ad valorem* tax on personalty?

- a. Taxpayer compliance is greater for personal use property than for business use property.
- b. The tax on automobiles sometimes considers the age of the vehicle.
- c. Most states impose a tax on intangibles.
- d. The tax on intangibles generates considerable revenue since it is difficult for taxpayers to avoid.
- e. None of these.

ANSWER: b

RATIONALE: Taxpayer compliance is greater with business use property (choice a.). Very few states impose a tax on intangibles (choice c.) because it is easily avoided and does not generate much revenue (choice d.).

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: SWFT.LO: 1-02 - LO: 1-02

Chapter 01 - Introduction to Taxation

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 5 min.

45. Federal excise taxes that are *no longer imposed* include:

- a. Tax on air travel.
- b. Tax on wagering.
- c. Tax on the manufacture of sporting equipment.
- d. Tax on alcohol.
- e. None of these.

ANSWER: e

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 5 min.

46. Taxes *not imposed* by the Federal government include:

- a. Tobacco excise tax.
- b. Customs duties (tariffs on imports).
- c. Tax on rental cars.
- d. Gas guzzler tax.
- e. None of these.

ANSWER: c

RATIONALE: The Federal government imposes an excise tax on tobacco (choice a.), customs duties (choice b.), and a gas guzzler tax (choice d.). It does not impose a tax on rental cars (choice c.).

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 5 min.

47. Taxes levied by *both* states and the Federal government include:

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- a. General sales tax.
- b. Custom duties.
- c. Hotel occupancy tax.
- d. Franchise tax.
- e. None of these.

ANSWER: e

RATIONALE: Choices a., c., and d. are levied at the state or local level. Choice b. is strictly a Federal levy.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 5 min.

48. Taxes levied by *all* states include:

- a. Tobacco excise tax.
- b. Individual income tax.
- c. Inheritance tax.
- d. General sales tax.
- e. None of these.

ANSWER: a

RATIONALE: All states impose a tobacco excise tax (choice a.). Most states impose individual income taxes (choice b.) and general sales taxes (choice d.), and only some states impose inheritance taxes (choice c.).

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 10 min.

49. A use tax is imposed by:

- a. The Federal government and all states.
- b. The Federal government and a majority of the states.
- c. All states and not the Federal government.
- d. Most of the states and not the Federal government.
- e. None of these.

ANSWER: d

RATIONALE: A use tax is a complement to a general sales tax. Consequently, it is imposed by most states because only a few states do not have a general sales tax. At this point, the Federal government has no general

Chapter 01 - Introduction to Taxation

sales tax.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: SWFT.LO: 1-02 - LO: 1-02

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

OTHER: Time: 5 min.

50. Burt and Lisa are married and live in a common law state. Burt wants to make gifts to their four children in 2016. What is the maximum amount of the annual exclusion they will be allowed for these gifts?

- a. \$14,000.
- b. \$28,000.
- c. \$56,000.
- d. \$112,000.
- e. None of these.

ANSWER: d

RATIONALE: $4 \text{ (number of donees)} \times \$14,000 \text{ (annual exclusion)} \times 2 \text{ (number of donors)} = \$112,000$. It is assumed that Lisa will make the election to split the gifts.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 10 min.

51. Property can be transferred within the family group by gift or at death. One motivation for preferring the gift approach is:

- a. To take advantage of the higher unified transfer tax credit available under the gift tax.
- b. To avoid a future decline in value of the property transferred.
- c. To take advantage of the per donee annual exclusion.
- d. To shift income to higher bracket donees.
- e. None of these.

ANSWER: c

RATIONALE: The per donee annual exclusion is only available for gift tax purposes (choice c.). Ideally, gifts should involve property that is expected to *appreciate* in value (choice b.). A higher unified tax credit is not available for gift tax purposes (choice a.). Usually the donor is trying to shift future income to *lower* bracket donees (choice d.).

POINTS: 1

Chapter 01 - Introduction to Taxation

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

CTIVES:

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 10 min.

52. Indicate which, if any, statement is *incorrect*. State income taxes:

- a. Can piggyback to the Federal version.
- b. Cannot apply to visiting nonresidents.
- c. Can decouple from the Federal version.
- d. Can provide occasional amnesty programs.
- e. None of these.

ANSWER: b

RATIONALE: Many states piggyback to the Federal system (choice a.). Some states, due to revenue shortfalls, have decoupled from various provisions of the Federal version (choice c.). The "jock tax," although much criticized, is very much in being (choice b.). Some states have had more than one amnesty period (choice d.).

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

CTIVES:

NATIONAL STANDARDS: United States - BUSPROG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 5 min.

53. State income taxes *generally* can be characterized by:

- a. The same date for filing as the Federal income tax.
- b. No provision for withholding procedures.
- c. Allowance of a deduction for Federal income taxes paid.
- d. Applying only to individuals and not applying to corporations.
- e. None of these.

ANSWER: a

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS: United States - BUSPROG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Knowledge

Chapter 01 - Introduction to Taxation

OTHER:

Time: 5 min.

54. Both economic and social considerations can be used to justify:

- a. Favorable tax treatment for accident and health plans provided for employees and financed by employers.
- b. Disallowance of any deduction for expenditures deemed to be contrary to public policy (e.g., fines, penalties, illegal kickbacks, bribes to government officials).
- c. Various tax credits, deductions, and exclusions that are designed to encourage taxpayers to obtain additional education.
- d. Allowance of a deduction for state and local income taxes paid.
- e. None of these.

ANSWER:

c

POINTS:

1

DIFFICULTY:

Moderate

LEARNING OBJECTIVES:

EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS:

United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS:

United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS:

Bloom's: Comprehension

OTHER:

Time: 10 min.

55. Social considerations can be used to justify:

- a. Allowance of a credit for child care expenses.
- b. Allowing excess capital losses to be carried over to other years.
- c. Allowing accelerated amortization for the cost of installing pollution control facilities.
- d. Allowing a Federal income tax deduction for state and local sales taxes.
- e. None of these.

ANSWER:

a

RATIONALE:

Equity considerations justify choices b. and d., and economic considerations justify choice c.

POINTS:

1

DIFFICULTY:

Easy

LEARNING OBJECTIVES:

EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS:

United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS:

United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS:

Bloom's: Comprehension

OTHER:

Time: 5 min.

56. Allowing a domestic production activities deduction for certain manufacturing income can be justified:

- a. As mitigating the effect of the annual accounting period concept.
- b. As promoting administrative feasibility.
- c. By economic considerations.
- d. Based on the wherewithal to pay concept.
- e. None of these.

ANSWER:

c

RATIONALE:

The deduction will encourage U.S. manufacturing. It also will lead to job growth and discourage the

Chapter 01 - Introduction to Taxation

outsourcing of labor to overseas.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTS: TX.SWFT.LO: 1-06 - LO: 1-06

IVES:

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

: AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 5 min.

57. Provisions in the tax law that promote energy conservation and more use of alternative (non-fossil) fuels can be justified by:

- a. Political considerations.
- b. Economic and social considerations.
- c. Promoting administrative feasibility.
- d. Encouragement of small business.
- e. None of these.

ANSWER: b

RATIONALE: Although it may be "good politics" to promote measures that ease the problem of global warming (choice a.), the real justification is economic (curtail dependence on foreign oil) and social (reduce pollution)—choice b. The encouragement of small business (choice d.) is a byproduct of these conservation provisions, but is not their justification.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTS: TX.SWFT.LO: 1-06 - LO: 1-06

IVES:

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 5 min.

58. Which, if any, of the following provisions *cannot* be justified as mitigating the effect of the annual accounting period concept?

- a. Nonrecognition of gain allowed for involuntary conversions.
- b. Net operating loss carryback and carryover provisions.
- c. Carry over of excess charitable contributions.
- d. Use of the installment method to recognize gain.
- e. Carry over of excess capital losses.

ANSWER: a

RATIONALE: The involuntary conversion provision is based on the wherewithal to pay concept (choice a.).

POINTS: 1

DIFFICULTY: Easy

Chapter 01 - Introduction to Taxation

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 5 min.

59. Which, if any, of the following provisions of the tax law *cannot* be justified as promoting administrative feasibility (simplifying the task of the IRS)?

- a. Penalties are imposed for failure to file a return or pay a tax on time.
- b. Prepaid income is taxed in the year received and not in the year earned.
- c. Annual adjustments for indexation increases the amount of the standard deduction allowed.
- d. Casualty losses must exceed 10% of AGI to be deductible.
- e. A deduction is allowed for charitable contributions.

ANSWER: e

RATIONALE: Choices a. through d. aid the IRS in administering the tax laws. Choice e., particularly when trying to value property contributions, will add to the audit effort required by the IRS.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

CTIVES:

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Risk Analysis

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 5 min.

60. A landlord leases property upon which the tenant makes improvements. The improvements are significant and are not made in lieu of rent. At the end of the lease, the value of the improvements are not income to the landlord. This rule is an example of:

- a. A clear reflection of income result.
- b. The tax benefit rule.
- c. The arm's length concept.
- d. The wherewithal to pay concept.
- e. None of these.

ANSWER: d

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 10 min.

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61. Taylor, a widow, makes cash gifts to her five married children (including their spouses) and to her seven grandchildren. What is the maximum amount Taylor can give for calendar year 2016 without using her unified transfer tax credit?

ANSWER: \$238,000. $\$14,000$ (annual exclusion) $\times$ 17 donees = \$238,000.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

NATIONAL STANDARDS:

United States - BUSPORG: Analytic

STATE STANDARDS:

United States - AK - AICPA: FN-Measurement -

AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 10 min.

62. Several years ago, Logan purchased extra grazing land for his ranch at a cost of \$240,000. In 2016, the land is condemned by the state for development as a highway maintenance depot. Under the condemnation award, Logan receives \$600,000 for the land. Within the same year, he replaces the property with other grazing land. What is Logan's tax situation if the replacement land cost:

- a. \$210,000?
- b. \$360,000?
- c. \$630,000?
- d. Why?

ANSWER:

- a. The full realized gain of \$360,000 [$\$600,000$ (condemnation proceeds) – $\$240,000$ (cost of land)] must be recognized, as only \$210,000 was reinvested. The condemnation proceeds of \$600,000 exceed the amount reinvested by more than \$360,000.
- b. As only \$360,000 was reinvested in replacement property, \$240,000 ($\$600,000 - \$360,000$) of the gain must be recognized.
- c. As the full \$600,000 was reinvested, no realized gain need be recognized.
- d. If some of the gain is not reinvested, consistent with the wherewithal to pay concept, there exists the ability to pay the tax. Thus, gain is recognized to the extent the proceeds are not reinvested.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 10 min.

63. Paige is the sole shareholder of Citron Corporation. During the year, Paige leases a building to Citron for a monthly rental of \$80,000. If the fair rental value of the building is \$60,000, what are the income tax consequences to the parties involved?

ANSWER: The rent charged by Paige is not "arms length"; as such, Citron Corporation's rent deduction is \$60,000 (not \$80,000). The \$20,000 difference is a nondeductible dividend distribution. For Paige, the change

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merely requires reclassification. Instead of \$80,000 of rent income, she has \$60,000 of rent income and \$20,000 of dividend income.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: SWFT.LO: 1-06 - LO: 1-06

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 10 min.

64. In 1985, Roy leased real estate to Drab Corporation for 20 years. Drab Corporation made significant capital improvements to the property. In 2005, Drab decides not to renew the lease and vacates the property. At that time, the value of the improvements is \$800,000. Roy sells the real estate in 2016 for \$1,200,000 of which \$900,000 is attributable to the improvements. When is Roy taxed on the improvements made by Drab Corporation?

ANSWER: Roy is not subject to taxation on the improvements until he disposes of the property (i.e., 2016). After a controversial Supreme Court decision years ago, Congress clarified the tax law to make it more consistent with the where-withal to pay concept.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: SWFT.LO: 1-07 - LO: 1-07

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 10 min.

65. Due to the population change, the Goose Creek School District has decided to close one of its high schools. Since it has no further need of the property, the school is listed for sale. The two bids it receives are as follows:

United Methodist Church	\$1,700,000
Planet Motors	1,600,000

The United Methodist Church would use the property to establish a sectarian middle school. Planet, a well-known car dealership, would revamp the property and operate it as a branch location.

If you were a member of the School District board, what factors would you consider in evaluating the two bids?

ANSWER: Although the bid from the United Methodist Church is higher, several other factors need to be considered. Does, for example, Goose Creek School district exempt property owned by churches from its *ad valorem* taxes? If so, losing this property from the tax base could prove very costly over the long run. Also, it is probable that income-producing property (such as a car dealership) would be taxed at a higher rate than that owned by a nonprofit organization (a school operated by a church). This assumes, of course, that the school would be taxed at all. The auto dealership also would generate sales tax.

POINTS: 1

DIFFICULTY: Easy

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LEARNING OBJECTIVES: 1-02 - LO: 1-02

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 10 min.

66. Morgan inherits her father's personal residence including all of the furnishings. She plans to add a swimming pool and sauna to the property and rent it as a furnished house. What are some of the *ad valorem* property tax problems Morgan can anticipate?

ANSWER: The real estate taxes probably will increase for several reasons. The capital improvements and the conversion from residential to rental will trigger the increase. Furthermore, the furnishings may generate an *ad valorem* tax on personalty. (Depending on applicable law, furniture might not be subject to tax unless used for business purposes—such as in this case.)

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: 1-02 - LO: 1-02

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 10 min.

67. In 2014, Deborah became 65 years old. In 2015 she added a swimming pool, and in 2016 she converted the residence to rental property and moved into an assisted living facility. Since 2013, Deborah's *ad valorem* property taxes have decreased once and increased twice. Explain.

ANSWER: The decrease probably came in 2014 when Deborah reached age 65. The increases probably occurred in 2015 when she added the pool and in 2016 when the residence was converted to rental property.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: 1-02 - LO: 1-02

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 10 min.

68. A lack of compliance in the payment of use taxes can be resolved by several means. In this regard, comment on the following:

- a. Registration of automobiles.
- b. Reporting of Internet purchases on state income tax returns.

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- ANSWER:*
- As reflected in Example 5, re-registration of a car purchased out-of-state is the occasion for the owner's home state to collect the use tax.
 - Completing the state income tax return reminds (or forces) the taxpayer to pay use tax on out-of-state-purchases.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

OBJECTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

STANDARDS: AICPA: FN-Measurement

United States - AK - AICPA: FN-Risk Analysis

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 5 min.

69. State and local governments are sometimes forced to find ways to generate additional revenue. Comment on the pros and cons of the following procedures:

- Decouple what would be part of the piggyback format of the state income tax.
- Tax amnesty provisions.
- Internet shaming.

- ANSWER:*
- The decoupling process is easily accomplished as to new Federal tax changes that have never taken effect at the state level. Taxpayers are not apt to miss what they never have enjoyed.
 - Tax amnesty provisions generate considerable revenue. It also unmask many taxpayers who have not previously paid taxes. Now that the taxing jurisdiction is aware of their existence, they will tend to pay taxes in the future.
 - By use of a public Web site, the taxing authority posts the names of those taxpayers that are delinquent as to various taxes (e.g., sales, income). This public humiliation (or threat of) very often results in compliance.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-02 - LO: 1-02

OBJECTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Evaluation

OTHER: Time: 10 min.

70. In terms of revenue neutrality, comment on a tax cut enacted by Congress that:

- contains revenue offsets.
- includes a sunset provision.

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- ANSWER:*
- Ideally, to achieve revenue neutrality all tax cuts should be accompanied by revenue offsets.
 - A sunset provision does not account for the immediate revenue losses generated by a tax cut. It merely provides that such losses will not continue beyond a specified date when the tax cut expires and the former tax law is reinstated.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 10 min.

71. The tax law contains various tax credits, deductions, and exclusions that are designed to encourage taxpayers to obtain additional education. On what grounds can these provisions be justified?

ANSWER: Social and economic considerations. As to the latter, a better educated workforce carries a positive economic impact.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 5 min.

72. The tax law contains various provisions that encourage home ownership.

- On what basis can this objective be justified?
- Are there any negative considerations? Explain.

ANSWER:

- Home ownership can be justified on economic and social grounds.
- Granting tax advantages to persons who are purchasing their homes places the taxpayers who rent at a disadvantage. The result is inequality in treatment.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

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OTHER: Time: 5 min.

73. The tax law allows an income tax deduction (or a credit) for foreign income taxes. Explain why.

ANSWER: The deduction (or a credit) for foreign income taxes can be justified on the grounds that it mitigates the double tax imposed on the same income.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

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KEYWORDS: Bloom's: Comprehension

OTHER: Time: 5 min.

74. The tax law allows, under certain conditions, deferral of gain recognition for involuntary conversions.

a. What is the justification for this relief measure?

b. What happens if the proceeds are not entirely reinvested?

ANSWER:

- a. By recognizing that the taxpayer's relative economic situation has not changed and that he or she lacks the wherewithal to pay a tax, any recognition of realized gain is deferred.
- b. If the proceeds from an involuntary conversion are not fully reinvested in property that is similar or related in service or use, recognized gain results. Such recognized gain cannot exceed realized gain and will be limited to the amount of the proceeds not reinvested. Recognition is based on the notion that the taxpayer now has the wherewithal to pay the tax that results.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

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AICPA: FN-Measurement

United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 10 min.

Using the choices provided below, show the justification for each provision of the tax law listed.

a. Economic considerations

b. Social considerations

c. Equity considerations

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-06 - LO: 1-06

NATIONAL STANDARDS: United States - BUSPROG: Technology: Technology: - BUSPROG: Technology

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United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

NOTES: B is also correct.

75. A tax credit for amounts spent to furnish care for children while the parent is at work.

ANSWER: b

POINTS: 1

76. Additional depreciation deduction allowed for the year the asset is acquired.

ANSWER: a

POINTS: 1

77. Tax brackets are increased for inflation.

ANSWER: c

POINTS: 1

78. A small business corporation can elect to avoid the corporate income tax.

ANSWER: a

POINTS: 1

79. A deduction for contributions by an employee to certain retirement plans.

ANSWER: a

POINTS: 1

80. A deduction for qualified tuition paid to obtain higher education.

ANSWER: a

POINTS: 1

81. A deduction for certain expenses (interest and taxes) incident to home ownership.

ANSWER: a

POINTS: 1

82. A Federal deduction for state and local income taxes paid.

ANSWER: c

POINTS: 1

83. A deduction for certain income from manufacturing activities.

ANSWER: a

POINTS: 1

84. A bribe to the local sheriff, although business related, is not deductible.

ANSWER: b

POINTS: 1

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85. Contributions to charitable organizations are deductible.

ANSWER: b

POINTS: 1

86. A Federal deduction for state and local sales taxes paid.

ANSWER: c

POINTS: 1

87. Tax credits available for the purchase of a vehicle that uses alternative (non-fossil) fuels.

ANSWER: a

POINTS: 1

88. Tax credits for home improvements that conserve energy.

ANSWER: a

POINTS: 1

89. More rapid expensing for tax purposes of the costs of installing pollution control devices.

ANSWER: a

POINTS: 1

90. Tomas owns a sole proprietorship, and Lucy is the sole shareholder of a C corporation. In the current year both businesses make a net profit of \$60,000. Neither business distributes any funds to the owners in the year. For the current year, Tomas must report \$60,000 of income on his individual tax return, but Lucy is not required to report any income from the corporation on her individual tax return.

a. True

b. False

ANSWER: True

RATIONALE: Proprietorship profits flow through to the owner and are reported on the owner's individual income tax return. It does not matter how much of the profit is withdrawn from the proprietorship. Thus, Tomas must report the net profit of \$60,000 on his Form 1040 (Schedule C). Shareholders are required to report income from a C corporation only to the extent of dividends received. Consequently, Lucy has no income to report from the corporation for the current year.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: SWFT.LO: 1-04 - LO: 1-04

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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STATE STANDARDS: United States - AK - AICPA: FN-Reporting

DS:

KEYWORDS: Bloom's: Application

OTHER: Time: 2 min.

91. Carol and Candace are equal partners in Peach Partnership. In the current year, Peach had a net profit of \$75,000 (\$250,000 gross income – \$175,000 operating expenses) and distributed \$25,000 to each partner. Peach must pay tax on \$75,000 of income.

a. True

b. False

Chapter 01 - Introduction to Taxation

ANSWER: False

RATIONALE: A partnership is not a taxpaying entity. Its profit (loss) and separate items flow through to the partners. The partnership's Form 1065 reports net profit of \$75,000. Carol and Candace both receive a Schedule K-1 reporting net profit of \$37,500. Each partner reports net profit of \$37,500 on her own return (Form 1040).

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: SWFT.LO: 1-04 - LO: 1-04

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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STATE STANDARDS: United States - AK - AICPA: FN-Reporting

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KEYWORDS: Bloom's: Application

OTHER: Time: 2 min.

92. Rajib is the sole shareholder of Robin Corporation, a calendar year S corporation. Robin earned net profit of \$350,000 (\$520,000 gross income – \$170,000 operating expenses) and distributed \$80,000 to Rajib. Rajib must report Robin Corporation profit of \$350,000 on his Federal income tax return.

- a. True
- b. False

ANSWER: True

RATIONALE: Similar to partnerships, the net profit or loss of an S corporation flows through to the shareholders to be reported on their individual tax returns. Robin's net income of \$350,000 is allocated entirely to Rajib, as the sole shareholder, and Rajib reports the \$350,000 of income on his Federal income tax return, regardless of how much of the income was withdrawn from the S corporation.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: SWFT.LO: 1-04 - LO: 1-04

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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KEYWORDS: Bloom's: Application

OTHER: Time: 2 min.

93. Donald owns a 45% interest in a partnership that earned \$130,000 in the current year. He also owns 45% of the stock in a C corporation that earned \$130,000 during the year. Donald received \$20,000 in distributions from each of the two entities during the year. With respect to this information, Donald must report \$78,500 of income on his individual income tax return for the year.

- a. True
- b. False

ANSWER: True

RATIONALE: On his individual income tax return for the year, Donald must report his \$58,500 ($\$130,000 \times 45\%$) share of the partnership income plus the \$20,000 of dividends he received from the C corporation, or \$78,500 of total income. Partnership income is taxed to a partner in the year earned, and distributions do not affect a partner's share of income. A C corporation's income is taxed to a shareholder only when

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distributed as dividends and to the extent thereof.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-04 - LO: 1-04

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NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

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KEYWORDS: Bloom's: Application

OTHER: Time: 2 min.

94. Quail Corporation is a C corporation with net income of \$125,000 during the current year. If Quail paid dividends of \$25,000 to its shareholders, the corporation must pay tax on \$100,000 of net income. Shareholders must report the \$25,000 of dividends as income.

- a. True
- b. False

ANSWER: False

RATIONALE: Quail Corporation must pay tax on the \$125,000 of corporate net income. Dividends paid are not deductible by the corporation. Shareholders must pay tax on the \$25,000 of dividends received from the corporation. This is commonly referred to as double taxation.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-04 - LO: 1-04

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NATIONAL STANDARDS: United States - BUSPORG: Analytic

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KEYWORDS: Bloom's: Application

OTHER: Time: 2 min.

95. Eagle Company, a partnership, had a short-term capital loss of \$10,000 during the year. Aaron, who owns 25% of Eagle, will report \$2,500 of Eagle's short-term capital loss on his individual tax return.

- a. True
- b. False

ANSWER: True

RATIONALE: Capital losses of a partnership pass through to the partners and are reported on such partners' tax returns.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-04 - LO: 1-04

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KEYWORDS: Bloom's: Application

OTHER: Time: 2 min.

96. Don, the sole shareholder of Pastel Corporation (a C corporation), has the corporation pay him a salary of \$600,000 in the current year. The Tax Court has held that \$200,000 represents unreasonable compensation. Don must report a salary of \$400,000 and a dividend of \$200,000 on his individual tax return.

- a. True
- b. False

ANSWER: True

RATIONALE: To the extent a salary paid to a shareholder/employee is considered reasonable, the corporation is allowed a salary deduction, which reduces corporate taxable income. To the extent a salary payment is not considered reasonable, the payment is treated as a dividend, which does not reduce corporate taxable income. The shareholder/employee is taxed on both salary (\$400,000) and dividends (\$200,000). (Pastel's taxable income increases by \$200,000, the amount of the unreasonable compensation paid to Don.)

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-04 - LO: 1-04

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NATIONAL STANDARDS: United States - BUSPORG: Analytic

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KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

97. Double taxation of corporate income results because dividend distributions are included in a shareholder's gross income but are not deductible by the corporation.

- a. True
- b. False

ANSWER: True

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-04 - LO: 1-04

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

98. Jake, the sole shareholder of Peach Corporation, a C corporation, has the corporation pay him \$100,000. For income tax purposes, Jake would prefer to have the payment treated as dividend instead of salary.

- a. True
- b. False

ANSWER: True

RATIONALE: Jake must include in gross income both salary and dividends, but he would prefer dividend income due to the preferential tax rate accorded such income.

POINTS: 1

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DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-04 - LO: 1-04

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement - AICPA: FN-Measurement

KEYWORDS: Bloom's: Comprehension

OTHER: Time: 2 min.

99. Juanita owns 60% of the stock in a C corporation that had a profit of \$200,000 in 2016. Carlos owns a 60% interest in a partnership that had a profit of \$200,000 during the year. The corporation distributed \$45,000 to Juanita, and the partnership distributed \$45,000 to Carlos. Which of the following statements relating to 2016 is *incorrect*?

- a. Juanita must report \$120,000 of income from the corporation.
- b. The corporation must pay corporate tax on \$200,000 of income.
- c. Carlos must report \$120,000 of income from the partnership.
- d. The partnership is not subject to a Federal entity-level income tax.
- e. None of the above.

ANSWER: a

RATIONALE: Shareholders of C corporations report the dividends received from the corporation during the year. Thus, Juanita must report \$45,000 of income from the corporation. The other statements are correct.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-04 - LO: 1-04

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

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KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

100. Bjorn owns a 60% interest in an S corporation that earned \$150,000 in 2016. He also owns 60% of the stock in a C corporation that earned \$150,000 during the year. The S corporation distributed \$30,000 to Bjorn and the C corporation paid dividends of \$30,000 to Bjorn. How much income must Bjorn report from these businesses?

- a. \$0 income from the S corporation and \$30,000 income from the C corporation.
- b. \$30,000 income from the S corporation and \$30,000 of dividend income from the C corporation.
- c. \$90,000 income from the S corporation and \$0 income from the C corporation.
- d. \$90,000 income from the S corporation and \$30,000 income from the C corporation.
- e. None of the above.

ANSWER: d

RATIONALE: Bjorn must report his \$90,000 share ($\$150,000 \times 60\%$) of the S corporation's income on his individual tax return. He will report \$30,000 of dividend income from the C corporation.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-04 - LO: 1-04

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KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

101. Rachel is the sole member of an LLC, and Jordan is the sole shareholder of a C corporation. Both businesses were started in the current year, and each business has a long-term capital gain of \$10,000 for the year. Neither business made any distributions during the year. With respect to this information, which of the following statements is correct?

- a. The C corporation receives a preferential tax rate on the LTCG of \$10,000.
- b. The LLC must pay corporate tax on taxable income of \$10,000.
- c. Jordan must report \$10,000 of LTCG on his tax return.
- d. Rachel must report \$10,000 of LTCG on her tax return.
- e. None of the above.

ANSWER: d

RATIONALE: Under the default rules of the check-the-box Regulations, a single-member LLC is treated as a proprietorship for Federal tax purposes. As such, Rachel reports the \$10,000 LTCG on her tax return (Form 1040). A C corporation does not receive preferential tax rate treatment on LTCG (option a.). The LLC is ignored for Federal income tax purposes and its income, gains, deductions, and losses are reported as a proprietorship, not as a corporation (option b.). A C corporation is a separate taxpaying entity (Form 1120) and income of a C corporation is not taxed to its shareholders until distributed as dividends (option c.).

POINTS: 1

DIFFICULTY: Easy

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KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

102. Norma formed Hyacinth Enterprises, a proprietorship, in 2016. In its first year, Hyacinth had operating income of \$400,000 and operating expenses of \$240,000. In addition, Hyacinth had a long-term capital loss of \$10,000. Norma, the proprietor of Hyacinth Enterprises, withdrew \$75,000 from Hyacinth during the year. Assuming Norma has no other capital gains or losses, and ignoring any self-employment taxes, how does this information affect her adjusted gross income for 2016?

- a. Increases Norma's adjusted gross income by \$157,000 (\$160,000 ordinary business income – \$3,000 long-term capital loss).
- b. Increases Norma's adjusted gross income by \$150,000 (\$160,000 ordinary business income – \$10,000 long-term capital loss).
- c. Increases Norma's adjusted gross income by \$75,000.
- d. Increases Norma's adjusted gross income by \$160,000.
- e. None of the above.

ANSWER: a

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RATIONALE: A proprietorship is not a separate taxable entity. As a proprietor, Norma reports profit or loss from Hyacinth on her individual return. Norma's adjusted gross income for 2016 will be increased by \$157,000 (\$400,000 – \$240,000 = \$160,000 net ordinary business income – \$3,000 capital loss deduction). The \$75,000 she withdrew from Hyacinth has no effect on her adjusted gross income.

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: SWFT.LO: 1-04 - LO: 1-04

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

DARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

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KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

103. Flycatcher Corporation, a C corporation, has two equal individual shareholders, Nancy and Pasqual. In the current year, Flycatcher earned \$100,000 net profit and paid a dividend of \$10,000 to each shareholder. Regardless of any tax consequences resulting from their interests in Flycatcher, Nancy is in the 33% marginal tax bracket and Pasqual is in the 15% marginal tax bracket. With respect to the current year, which of the following statements is *incorrect*?

- a. Flycatcher cannot avoid the corporate tax altogether by distributing all \$100,000 of net profit as dividends to the shareholders.
- b. Nancy incurs income tax of \$1,500 on her dividend income.
- c. Pasqual incurs income tax of \$1,500 on his dividend income.
- d. Flycatcher pays corporate tax of \$22,250.
- e. None of the above.

ANSWER: c

RATIONALE: A preferential tax rate of 0% applies to dividend income of individual taxpayers in the lowest two marginal tax brackets (10% or 15%); thus, Pasqual pays income tax of \$0 on his dividend income. A preferential tax rate of 15% applies to dividend income of individual taxpayers in the 33% tax rate brackets; thus, Nancy pays income tax of \$1,500 on her dividend income (option b.). Dividend distributions are not deductible by a corporation, and Flycatcher still incurs corporate tax on \$100,000 even if all profits were distributed to shareholders (option a.). Corporate tax on \$100,000 of taxable income is \$22,250 (option d.).

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: SWFT.LO: 1-04 - LO: 1-04

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

104. Pablo, a sole proprietor, sold stock held as an investment for a \$40,000 long-term capital gain. Pablo's marginal tax rate is 33%. Loon Corporation, a C corporation, sold stock held as an investment for a \$40,000 long-term capital gain. Loon's marginal tax rate is 35%. What tax rates are applicable to these capital gains?

- a. 15% rate applies to Pablo and 35% rate applies to Loon.

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- b. 15% rate applies to Loon and 33% rate applies to Pablo.
- c. 35% rate applies to Loon and 33% rate applies to Pablo.
- d. 15% rate applies to both Pablo and Loon.
- e. None of the above.

ANSWER: a

RATIONALE: Pablo reports the LTCG on his individual tax return (Form 1040, Schedule D), and it is subject to a maximum tax rate of 15%. Loon reports the LTCG on its corporate return (Form 1120) but the gain does not receive preferential tax rate treatment. Therefore, the LTCG will be taxed at 35%.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: LO: 1-04 - LO: 1-04

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

DS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

105. Lucinda is a 60% shareholder in Rhea Corporation, a calendar year S corporation. During the year, Rhea Corporation had gross income of \$550,000 and operating expenses of \$380,000. In addition, the corporation sold land that had been held for investment purposes for a short-term capital gain of \$30,000. During the year, Rhea Corporation distributed \$50,000 to Lucinda. With respect to this information, which of the following statements is correct?

- a. Rhea Corporation will pay tax on taxable income of \$200,000.
- b. Lucinda reports ordinary income of \$50,000.
- c. Lucinda reports ordinary income of \$120,000.
- d. Lucinda reports ordinary income of \$102,000 and a short-term capital gain of \$18,000.
- e. None of the above.

ANSWER: d

RATIONALE: Rhea Corporation, an S corporation, is not a taxpaying entity (option a.). Its profit (loss) and separate items flow through to the shareholders. The corporation's Form 1120S reports ordinary business income of \$170,000 (\$550,000 income – \$380,000 expenses). The corporation also reports the \$30,000 short-term capital gain as a separately stated item. Lucinda receives a Schedule K-1 reporting ordinary business income of \$102,000 (60% × \$170,000) and separately stated short-term capital gain of \$18,000 (60% × \$30,000), and she will report such income on her own return. The distributions are not taxable for Lucinda but decrease the basis in her Rhea Corporation stock.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: LO: 1-04 - LO: 1-04

CTIVES:

NATIONAL STANDARDS: United States - BUSPORG: Analytic

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STATE STANDARDS: United States - AK - AICPA: FN-Reporting

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KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

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106. Elk, a C corporation, has \$370,000 operating income and \$290,000 operating expenses during the year. In addition, Elk has a \$10,000 long-term capital gain and a \$17,000 short-term capital loss. Elk's taxable income is:

- a. \$63,000.
- b. \$73,000.
- c. \$80,000.
- d. \$90,000.
- e. None of the above.

ANSWER: c

RATIONALE: $\$370,000$ (operating income) – $\$290,000$ (operating expenses) + $\$10,000$ (LTCL) – $\$10,000$ (STCL) = $\$80,000$ taxable income. A corporation cannot deduct a net capital loss in the year incurred. The net capital loss (\$7,000) can be carried back three years and offset against net capital gain in the carryback years. If the capital loss is not used in the carryback, it can be carried forward five years. Capital gains of corporations are included in taxable income and are not subject to the favorable rates applicable to individuals.

POINTS: 1

DIFFICULTY: Easy

LEARNING OBJECTIVES: 1-04 - LO: 1-04

CTIVES:

NATIONAL STANDARDS: United States - BUSPROG: Analytic

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United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Application

OTHER: Time: 5 min.

107. During the current year, Skylark Company had operating income of \$420,000 and operating expenses of \$250,000. In addition, Skylark had a long-term capital loss of \$20,000, and a charitable contribution of \$5,000. How does Toby, the sole owner of Skylark Company, report this information on his individual income tax return under following assumptions?

- a. Skylark is an LLC, and Toby does not withdraw any funds from the company during the year.
- b. Skylark is an S corporation, and Toby does not withdraw any funds from the company during the year.
- c. Skylark is a regular (C) corporation, and Toby does not withdraw any funds from the company during the year.

ANSWER:

- a. A single-member LLC is taxed as a proprietorship. Consequently, Toby reports the \$170,000 operating profit, \$20,000 long-term capital loss, and \$5,000 charitable contribution on his individual return (Form 1040). The capital loss limitation may apply to the LTCL depending on Toby's other capital gains and losses, if any.
- b. Income, deductions, gains, and losses of an S corporation flow through to the shareholders. Separately stated items (e.g., LTCL and charitable contribution) retain their character at the shareholder level. Consequently, Toby reports the \$170,000 operating profit, \$20,000 long-term capital loss, and \$5,000 charitable contribution on his individual return (Form 1040). The capital loss limitation may apply to the LTCL.
- c. Shareholders of a regular (C) corporation report income from the corporation to the extent

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of dividends received. Therefore, Toby does not report any of Skylark's operating profit, long-term capital loss, or charitable contribution on his individual return. [Skylark Company would report taxable income of \$165,000 (\$170,000 operating profit – \$5,000 charitable contribution) on its corporate return (Form 1120). The net capital loss of \$20,000 is not deductible in the current year; rather, the loss is carried back three years and forward five years (as STCL).]

POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-04 - LO: 1-04

NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Reporting

KEYWORDS: Bloom's: Application

OTHER: Time: 10 min.

108. Amber Company has \$100,000 in net income in the current year before deducting any compensation or other payment to its sole owner, Alfredo. Assume that Alfredo is in the 33% marginal tax bracket. Discuss the tax aspects of each of the following independent situations. (Assume that any salaries are reasonable in amount and ignore any employment tax considerations.)

- a. Alfredo operates Amber Company as a proprietorship.
- b. Alfredo incorporates Amber Company and pays himself no salary and no dividend.
- c. Alfredo incorporates Amber Company and pays himself a \$50,000 salary and a dividend of \$42,500 (\$50,000 – \$7,500 corporate income tax).

<i>ANSWER:</i>	a. Alfredo's tax on \$100,000 at 33%	<u>\$33,000</u>
	Amber's tax on \$100,000 at corporate rates	<u>\$22,250</u>
	Amber's tax on \$50,000 at corporate rates	\$ 7,500
	Alfredo's tax on \$42,500	6,375

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dividend	
distributed at	
15%	
Alfredo's tax	
on \$50,000 salary at 33%	<u>16,500</u>
Total tax	<u>\$30,375</u>

POINTS: 1

DIFFICULTY: Challenging

LEARNING OBJECTIVES: EOTX.SWFT.LO: 1-04 - LO: 1-04

OBJECTIVES:

NATIONAL STANDARDS: United States - BUSPROG: Analytic

STANDARDS:

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -

ARDS: AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 10 min.

109. During the current year, Maroon Company had \$125,000 net income from operations. Belinda, the sole owner of Maroon, is in the 33% marginal tax bracket. Determine the combined tax burden for Maroon and Belinda under the following independent situations. (Ignore any employment taxes.)

- Maroon Company is a C corporation and all of its after-tax income is distributed to Belinda.
- Maroon Company is a proprietorship and all of its after-tax income is withdrawn by Belinda.
- Maroon Company is an S corporation and all of its after-tax income is distributed to Belinda.

ANSWER:

- If Maroon Company is a C corporation, the \$125,000 is taxable at the corporate level (Form 1120), resulting in corporate tax of \$32,000 $[(\$50,000 \times 15\%) + (\$25,000 \times 25\%) + (\$25,000 \times 34\%) + (\$25,000 \times 39\%)]$. The after-tax dividend distribution of \$93,000 $(\$125,000 - \$32,000)$ to Belinda results in tax of \$13,950 $(\$93,000 \times 15\%)$. Total taxes amount to \$45,950 $(\$32,000 + \$13,950)$.
- If Maroon Company is a proprietorship, there is no entity level Federal income tax. Instead, the income of the proprietorship is reported on Belinda's tax return (Form 1040), resulting in tax of \$41,250 $(\$125,000 \times 33\%)$. Belinda's withdrawal of the after-tax income has no income tax consequences.
- Income, deductions, gains, and losses of an S corporation flow through to the shareholders. Consequently, Belinda reports the \$125,000 net profit on her individual return (Form 1040), resulting in tax of \$41,250 $(\$125,000 \times 33\%)$. Distributions from S corporations are nontaxable to the shareholder (to the extent of stock basis).

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POINTS: 1

DIFFICULTY: Moderate

LEARNING OBJECTIVES EOTX.SWFT.LO: 1-04 - LO: 1-04

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NATIONAL STANDARDS: United States - BUSPORG: Analytic

STATE STANDARDS: United States - AK - AICPA: FN-Measurement -
AICPA: FN-Measurement

KEYWORDS: Bloom's: Application

OTHER: Time: 10 min.