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## Roger CPA Review Questions

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# **ROGER**

## *CPA Review*

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## **4 Tax Questions**

*for SJSU MST Contemporary Tax Journal*

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1. In June of Year 2, Vasilia received a state income tax refund of \$500 for overpayment of state income tax in Year 1. Vasilia deducted \$1,800 of state income tax on Form 1040 for Year 1, making Vasilia's itemized deductions exceed the applicable standard deduction in Year 1 by \$300. What amount, if any, of the state income tax refund is taxable on Vasilia's Year 2 Form 1040?

- a) \$0
- b) \$200
- c) \$300
- d) \$500

**c) Correct!** When a taxpayer receives a refund for an amount previously claimed as a deduction, the refund is taxable in the year received to the extent that a tax benefit was derived from the deduction. Since Vasilia received a tax benefit of only \$300 by itemizing deductions rather than claiming the standard deduction, only \$300 of the refund is taxable in Year 2.

2. The deduction of operating losses flowing through to an individual taxpayer's return from a passive activity generally is limited by each of the following **except**

- a) Basis.
- b) Passive income.
- c) Portfolio income.
- d) Amount at-risk.

**c) Correct!** The deduction of operating losses flowing through to an individual taxpayer's return from a passive activity generally is limited first by the taxpayer's basis in the activity. Losses that make it past the basis limitation are then further limited by the at-risk rules (i.e., amounts considered "at-risk," such as S corporation debt basis). Any losses remaining after the at-risk rules are applied may be deducted to the extent the taxpayer has income from other passive activities. Losses from passive activities may not be deducted against portfolio or active income. Losses barred from deduction by any of these limitations in the current year are suspended until such limitations will allow.

3. Wendy, a single individual, actively participates in a 50%-owned rental real estate activity that produces an \$80,000 loss in year 1. Wendy's adjusted gross income was \$110,000 before considering the rental activity. What amount of the rental loss, if any, is Wendy entitled to deduct for year 1?

- a) \$0
- b) \$20,000
- c) \$25,000
- d) \$40,000

**b) Correct!** If a taxpayer actively participates in rental activities, even though they are not a "real estate person," they qualify for a deduction of up to \$25,000 of rental losses against ordinary income. However, the \$25,000 loss allowance is reduced by 50% of the excess of the taxpayer's (single or joint filers) modified AGI (MAGI) over \$100,000. In this case, Wendy, who files as single and has MAGI of \$110,000, must reduce the \$25,000 allowance by \$5,000 (i.e.,  $\$110,000 \text{ MAGI} - \$100,000 \text{ threshold} = \$10,000 \times 50\% = \$5,000 \text{ reduction}$ ). Thus, Wendy may deduct \$20,000 of her \$40,000 loss ( $\$80,000 \times 50\%$ ) against ordinary income in Year 1. The remaining \$20,000 passive loss will carry over to the next year.

4. Quanti Co., a calendar-year taxpayer, purchased small tools for \$5,000 on December 21, year 1, representing the company's only purchase of tangible personal property that took place during year 1. Assume Quanti Co. does not want to take §179 or bonus depreciation on the tools. On its year 1 tax return, how many months of MACRS depreciation may Quanti Co. claim on the tools?

- a) One-and-a-half months.
- b) One month.
- c) Six months.
- d) None.

**a) Correct!** In most cases, MACRS involves applying the half-year convention, under which assets are amortized for one-half of the year in the year of acquisition and in the year of disposal. When an entity acquires at least 40% of its depreciable and amortizable assets in the final 3 months of the year, the mid-quarter convention is applied, under which depreciation is calculated for only one-half of the last quarter of the year, or 1 ½ months.