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Roger CPA Review Questions

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Regulation CPA Exam Questions

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Sample CPA Exam Question & Answer Explanation 1

An employed, married taxpayer owns three rental properties in which the taxpayer does not actively participate. In the current year, Property 1 had a net loss of \$10,000, Property 2 had a net gain of \$25,000, and Property 3 had a net loss of \$5,000. The taxpayer's W-2 wages were \$110,000. Considering only these facts, what is the taxpayer's adjusted gross income?

- A) \$110,000
- B) \$120,000
- C) \$125,000
- D) \$135,000

Correct: B

Passive income includes trade or business activities in which the taxpayer does not materially participate (eg, partnerships, S corporations) and all rental activities. Passive activity losses are deductible to the extent of passive activity income. Unused losses are suspended and carried forward to offset future passive income.

There are two exceptions regarding losses from rental real estate activities. The exceptions require that the taxpayer either actively participate in the rental activity or is considered a real estate professional. If neither exception applies, the passive loss deduction is limited to passive income.

Because this taxpayer does not actively participate in the rental real estate activities and is not considered a real estate professional, neither exception applies. Therefore, the losses from the rental activities may offset only passive income. The taxpayer's AGI is \$120,000.

(Choice A) AGI of \$110,000 implies that only the W-2 wages are considered as income. The net income from the passive rental activities is also taxable.

(Choice C) AGI of \$125,000 ($\$110,000 + \$25,000 - \$10,000$) suggests that only Property 1's loss of \$10,000 is deductible; however, the entire \$15,000 is deductible against the \$25,000 passive income.

(Choice D) AGI of \$135,000 ($\$110,000 + \$25,000$) incorrectly assumes that none of the passive losses are deductible. Passive losses are deductible to the extent of passive income.

Things to remember:

Passive income includes trade or business activities in which the taxpayer does not materially participate (eg, partnerships, S corporations) and all rental activities (except for those of a real estate professional). Passive activity losses are deductible to the extent of passive activity income (unless the active participation exception applies).

Sample CPA Exam Question & Answer Explanation 2

A 2018 divorce decree provides that Alex pay alimony of \$10,000 per year to Blair, to be reduced by 20% on their child's 18th birthday. The divorce decree has not been modified. During the tax year, Alex paid \$7,000 directly to Blair and \$3,000 for Blair's tuition to an accredited university. What amount, if any, of these payments should be reported as income in Blair's income tax return for the year?

- A) \$0
- B) \$7,000
- C) \$8,000
- D) \$10,000

Correct: C

Prior to the Tax Cuts and Jobs Act (TCJA), alimony payments were income to the payee and deductible to the payer. TCJA flipped the rules for divorce decrees issued or modified after 2018 so that alimony is no longer included in taxable income, nor is it deductible. Note that modified divorce decrees must specifically elect the TCJA rules in the modification.

Among the many specific rules regarding alimony, one important rule is that alimony must not contain any type of disguised child support. The \$10,000 annual payment decreases 20% (\$2,000) when the child reaches 18 years; therefore, it is considered disguised child support. This portion is not taxable to Blair (nor deductible by Alex). Only 80% (\$8,000) is true alimony and included in Blair's income tax return.

(Choice A) Since the divorce settlement was issued prior to 2019, Blair must still include the alimony payment in income. However, if the TCJA rules applied because the divorce decree was issued or modified after 2018, \$0 would be correct.

(Choices B and D) When the pre-TCJA rules applied, amounts paid on behalf of the spouse were considered taxable alimony. Alex's \$3,000 payment for Blair's tuition is also alimony, not just the \$7,000 direct payment. However, the full amount of \$10,000 ignores the 20% portion that is considered child support.

Things to remember:

Alimony paid pursuant to a divorce decree issued on or before December 31, 2018, is taxable income to the payee (and deductible by the payer). When those pre-TCJA rules apply, alimony must not contain any disguised child support. For divorce decrees issued or modified after 2018, alimony is no longer taxable or deductible.

Sample CPA Exam Question & Answer Explanation 3

Cobb, Danver, and Evans each owned a one-third interest in the capital and profits of their calendar-year partnership. On September 18 of Year 1, Cobb and Danver sold their partnership interests to Frank and immediately withdrew from all participation in the partnership. On March 15 of Year 2, Cobb and Danver received full payment from Frank for the sale of their partnership interests. For tax purposes, the partnership

- A) Terminated on September 18 of Year 1.
- B) Terminated on December 31 of Year 1.
- C) Terminated on March 15 of Year 2.
- D) Did not terminate.

Correct: D

A partnership generally terminates for tax purposes when no part of the business, financial operations, or venture of the partnership is carried on by any of its partners. Here, the partnership did not terminate because there was no agreement to dissolve, wind up the business, and distribute property to the partners. The partnership business continued with original partner Evans (33.33%) and new partner Frank (66.67%).

The TCJA of 2017 repealed the rule that a partnership be terminated for tax purposes when 50% or more of the partnership interests changed hands within a 12-month period. The current IRS rule now aligns with how partnership terminations are generally treated under state law.

Things to remember:

For tax purposes a partnership terminates when no part of the business, financial operations, or venture of the partnership is carried on by any of its partners.

Sample CPA Exam Question & Answer Explanation 4

Which of the following items is not normally taken into account in determining distributable net income of a simple trust?

- A) Tax-exempt interest.
- B) Fiduciary fee.
- C) Taxable interest income.
- D) Personal exemption.

Correct: D

A trust's distributable net income (DNI) represents current income, including taxable and tax-exempt interest, available to be distributed to beneficiaries after paying costs incurred by the trust (eg, fiduciary fees) **(Choices A, B, and C)**. DNI determines the maximum amount of (1) distributed income that is taxable to beneficiaries, and (2) the trust's deduction for distributed income. Capital gains and losses are generally excluded from DNI since the proceeds are considered a return of corpus (ie, property transferred to the trust).

A personal exemption is solely a statutory amount allowed to reduce taxable income. As such, a personal exemption is not an actual cost incurred that would reduce the amount available for distribution and is not used to determine DNI.

Things to remember:

Distributable net income (DNI) represents the remaining current income after paying incurred costs and is available to be distributed to beneficiaries. Because the personal exemption is a statutory amount that is not an actual incurred cost, the personal exemption does not affect DNI.

Sample CPA Exam Question & Answer Explanation 5

An LLC exchanged an office building with a fair market value of \$550,000 and an adjusted basis of \$220,000 for a shopping center with a fair market value of \$600,000. If the LLC paid an additional \$50,000 to complete the exchange, what amount of gain, if any, would the LLC realize?

- A) \$0
- B) \$50,000
- C) \$330,00
- D) \$380,00

Correct: C

A like-kind exchange is a nontaxable trade of investment/business real property (ie, qualified property) for similar qualified property of equal fair market value (FMV) (\$600,000 FMV = \$550,000 FMV + \$50,000 cash). Although no gain or loss is recognized, any realized gain or loss is deferred until the property received is disposed (eg, sold) **(Choice A)**.

Like other dispositions, realized gain or loss is the difference between the FMV of property (including cash) received and the adjusted basis of property given (including cash) (FMV received – adjusted basis and cash given).

The LLC received a shopping center (\$600,000 FMV) by giving cash (\$50,000) and a building (\$220,000 adjusted basis). Therefore, the LLC realized a gain of \$330,000 [$\$600,000 - (\$50,000 + \$220,000)$].

The office building's \$550,000 FMV is not used to determine the realized gain but is considered when determining if the transaction is an even economic trade.

(Choice B) An amount of \$50,000 represents boot (ie, additional consideration offsetting the difference between the two buildings' FMVs).

(Choice D) An amount of \$380,000 represents the difference between the FMV received and the office building's adjusted basis but omits additional cash or boot given.

Things to remember:

A like-kind exchange (LKE) is a nontaxable trade of qualified property for similar qualified property of equal fair market value (FMV). Although no gain or loss is recognized, any realized gain or loss on an LKE is deferred until the asset is disposed. The realized gain or loss is determined by subtracting the adjusted basis of property given from the FMV of property received.