[The Contemporary Tax Journal](https://scholarworks.sjsu.edu/sjsumstjournal)

Volume 11
Issue 2 *The Contemporary Tax Journal Volume 11, No. 2 – Summer 2022*

Article 10

8-18-2022

CPA Exam Review Questions Provided Courtesy of Gleim CPA Review

CPA Exam Review Questions Provided Courtesy of Gleim CPA Review

Study Unit 4.1
Source: CPA 20 REG-11

Required: The amount of gross income from a contribution to and earnings from a qualified-defined contribution plan.

The following Year 1 annual report was received by Clark from the qualified-defined contribution plan provided by Clark's employer:

Beginning balance	$12,700
Employer contribution	600
Plan earnings	250
Ending balance	$13,500

What income must be included in Clark's gross income for Year 1?

A. $0

B. $250

C. $600

D. $850

Explanation

1. **Choice "A" is correct.** Employer contributions to qualified retirement plans are not included in income until distributed. Earnings from the plan also are not taxed until distribution. Clark's report includes an employer contribution and earnings but no distribution; therefore, there is no income inclusion for Year 1.

2. Choice "B" is incorrect. The $250 of earnings from Clark's qualified plan will not be taxed until distributed.

3. Choice "C" is incorrect. Clark's employer's $600 contribution to the qualified retirement plan will not be included in income until distributed.

4. Choice “D” is incorrect. Neither the employer’s $600 contribution to, nor the $250 of earnings from, the qualified retirement plan were distributed; therefore, they are not included in income.

Study Unit 7.2
Source: CPA 21 REG-30

Required: The amount of deductible investment interest expense.

Jefferson's investment income consisted of $2,000 in interest from a U.S. Treasury bond and $1,000 interest from a municipal bond. Jefferson also paid $4,000 in investment interest expense. Assuming that Jefferson itemizes, what amount can Jefferson deduct for investment interest expense?

A. $1,000

B. $2,000

C. $3,000

D. $4,000

Explanation

1. **Choice "B" is correct.** Investment interest expense is only deductible to the extent of net investment income. Taxable investment income does not include tax-exempt municipal bond interest. Because the $2,000 U.S. Treasury bond interest income is the only taxable investment income, only $2,000 of the investment interest expense may be deducted in the current year.

2. Choice "A" is incorrect. Because the interest from the municipal bond is not taxable, deduction of investment interest expense is not permitted.

3. Choice "C" is incorrect. Investment interest expense is deductible only to the extent of net investment taxable income.

4. Choice "D" is incorrect. The full $4,000 investment interest expense is not deductible.

Study Unit 12.2
Source: CPA 21 REG-35

Required: The true statement regarding the corporations' eligibility to file a consolidated return.

The following information relates to three corporations: Mauve, Teal, and Fuchsia.

Stockholders	Mauve	Teal	Fuchsia
Adams	10%	18%	22%
Jefferson	40%	22%	0%
Washington	50%	0%	0%
Brook	0%	33%	70%
Smith	0%	27%	8%
Total	100%	100%	100%

None of the corporations has made a subchapter S election. Which of the following statements about the corporations is true?

A. All three corporations must file a consolidated return.

B. All three corporations can elect to file a consolidated return.

C. Two of the three corporations can elect to file a consolidated return.

D. None of the corporations can file a consolidated return.

Explanation

1. **Choice "D" is correct.** A single federal income tax return may be filed by two or more includible corporations that are members of an affiliated group. Includible corporations are all corporations except the following:
    1. Tax-exempt corporations
    2. S corporations
    3. FSCs (foreign sales corporations)
    4. Insurance corporations
    5. REITs (real estate investment trusts)
    6. Regulated investment companies
    7. DISCs (domestic international sales corporations

    An affiliated group includes each corporation in a chain of corporations under the following conditions:

    1. The other group members must directly own stock in the corporation that represents both

a. 80% or more of total voting power and

b. 80% or more of total value outstanding.

2. A parent corporation must directly own stock as outlined in 1. above (80% voting and value) of at least one includible corporation.

Thus, since the 80% criteria has not been met, a consolidated return is not filed.

2. Choice “A” is incorrect. The three corporations are not required to file a consolidated return. In addition, none of the corporations are affiliated.

3. Choice “B” is incorrect. The three corporations do not meet the affiliated criteria to elect to file a consolidated return.

4. Choice “C” is incorrect. None of the corporations are affiliated with each other, and a consolidated return is not filed.

Study Unit 14.2
Source: CPA 20 REG-38

Required: The shareholder's basis in the S corporation.

Mark and Mary formed MM, Inc., as an S corporation. Each contributed $50,000 in exchange for five shares of corporate stock. In addition, MM obtained a $60,000 loan from a local bank that was still outstanding at the end of the year. In MM's first year of operation, it reported a loss of $20,000 and did not make any distributions to the shareholders. What is Mark's basis in his MM shares at the beginning of the second year?

A. $40,000

B. $50,000

C. $70,000

D. $100,000

Explanation

1. **Choice "A" is correct.** If a shareholder purchases stock, the shareholder's original basis in the stock is its cost. Third-party loans to an S corporation do not increase the shareholder's basis until payments are made on the loan. In this case, the original basis in the stock is $50,000 for each shareholder. Each shareholder's share of the loss is $10,000 ($20,000 × 50% ownership). Therefore, Mark's basis in the S corporation's shares at the beginning of the second year is $40,000 ($50,000 basis in shares – $10,000 share of loss).

2. Choice "B" is incorrect. The amount of $50,000 is the basis each shareholder contributed to the S corporation. It does not take into the account the reported loss during the first year of operations.

3. Choice "C" is incorrect. Third-party loans to an S corporation do not increase the shareholder's basis until payments are made on the loan.

4. Choice "D" is incorrect. The amount of $100,000 is the total initial basis in the corporate stock, not just Mark's basis. Each individual shareholder's basis in the S corporation is the shareholder's cost of the stock, adjusted for the shareholder's pro rata share of the corporation's losses.

Study Unit 16.3
Source: CPA 21 REG-33

Required: The partner's basis in assets post liquidating distribution.

A partner receives the following as part of a liquidating distribution:

	Basis	FMV
Cash	$12,000	$12,000
Accounts receivable (A/R)	0	4,000
Land	8,000	3,000
Total	$20,000	$19,000

The partner's basis in the partnership immediately prior to the distribution is $25,000. What is the partner's basis in the A/R and the land immediately after the liquidating distribution?

A. A/R: $4,000, land: $3,000.

B. A/R: $0, land: $13,000.

C. A/R: $13,000, land: $0.

D. A/R: $0, land: $8,000.

Explanation

1. **Choice "B" is correct.** The basis of properties distributed by a partnership in a liquidating distribution to a partner is the adjusted basis of the partner's interest in the partnership less any money received in the same distribution. The basis of distributed property is allocated first to inventory items and unrealized receivables up to the amount of the partnership's adjusted basis in these items, then to other property to the extent of each distributed property's adjusted basis to the partnership. The distributee's basis in (noncash) property received in a distribution in liquidation is any excess of his or her AB in the partnership interest immediately before distribution over any amount of money received.

Partner's basis in partnership	$25,000
Less: Cash received	(12,000)
Adjusted basis	$13,000
Less: Basis in A/R	(0)
Basis in land	$13,000

2. Choice "A" is incorrect. The partner's basis is not the FMV of the A/R and land.

3. Choice “C” is incorrect. The basis of distributed property is allocated first to inventory items and unrealized receivables up to the amount of the partnership’s adjusted basis in these items, then to other property to the extent of each distributed property’s adjusted basis to the partnership.
4. Choice “D” is incorrect. The partner’s basis in the land is greater than $8,000.

Acknowledgement

Thank you to Gleim CPA Review for providing these questions to *The Contemporary Tax Journal.*

Gleim CPA Review — Regulation (REG) Sample Questions

If you plan on sitting for a high-stakes test like the CPA Exam, you need exposure to the types of questions you'll see on test day. It gives you the opportunity to learn and understand accounting concepts at a deeper level, which translates into greater success on the CPA Exam.

Over the last 45+ years, millions of candidates have trusted Gleim to prepare them to pass the CPA Exam. Our goal is to provide CPA prep materials that give you a competitive advantage as you transition from the accounting classroom to taking the CPA Exam and beyond.

All of our questions have expertly-authored explanations for the right and wrong answers, so you can build your confidence and skill at every stage of your exam prep.

We're excited to help you earn your passing score.

To learn more about the full Gleim CPA Review course and CPA Exam requirements and content, visit gleim.com/cpa

***Reprinted in* The Contemporary Tax Journal**

with permission of Gleim CPA Review.