

Regulation (REG)

AICPA

Released Questions -  
2022



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*Note: Any knowing solicitation or disclosure of any questions or answers included on any CPA examination is prohibited*

# Multiple Choice Question #1:

A client claims to have driven 50,000 miles for business purposes during the preceding year and wishes to deduct all of the mileage. The CPA suspects that the client is overstating the amount of mileage actually driven for business purposes. According to Treasury Department Circular 230, the CPA should do which of the following?

- A. Deduct only the amount of mileage for business purposes that the CPA believes is reasonable.
- B. Make reasonable inquiries about the information supplied.
- C. Prepare the tax return without asking any questions.
- D. Put a note in the client's file indicating that the client made an oral declaration about mileage driven for business purposes.

Correct Answer: B

## Multiple Choice Question #2:

The only entity that can censure a CPA or revoke a license to practice as a CPA is

- A. The National Association of State Boards of Accountancy.
- B. The state board of accountancy for the state in which the CPA practices.
- C. The Securities and Exchange Commission.
- D. The American Institute of Certified Public Accountants.

Correct Answer: B

## Multiple Choice Question #3:

A CPA quickly prepares the financial statements for WSA Co. without noticing that an asset was inadvertently overstated on the balance sheet by 10%. An investor who had purchased stock in WSA based on the financial statements, lost \$10,000 as a result of the investment. The investor claims that WSA committed fraud. Which of the following is true concerning whether fraud was committed?

- A. Fraud was committed because the balance sheet is misstated.
- B. Fraud was **not** committed because the investor's damages are **not** material.
- C. Fraud was committed because the reliance was placed on the statements by the investor.
- D. Fraud was **not** committed because the misstatement was due to negligence.

Correct Answer: D

## Multiple Choice Question #4:

Under agency law, which of the following sets of categories refer to principals?

- A. Formal, mutual, and informal.
- B. Actual, express, and implied.
- C. General, special, and gratuitous.
- D. Disclosed, partially disclosed, and undisclosed.

Correct Answer: D

## Multiple Choice Question #5:

CJN Corp. contracts with James, Inc. to sell James's 130 acres of ocean-front property and requires James to submit the entire balance upon closing. CJN refuses to close the sale. James has which of the following remedies available to it?

- A. Compensatory damages or specific performance.
- B. Specific performance and compensatory damages.
- C. Consequential damages or punitive damages.
- D. Punitive damages and compensatory damages.

Correct Answer: A

## Multiple Choice Question #6:

A U.S. citizen and an individual who is a resident and citizen of Australia want to form a business association to sell farm equipment in the United States. They want limited liability to the extent of their investments, to be taxed as a flow-through, and to both actively participate in management. Which of the following types of business organizations best fits their needs?

- A. S corporation.
- B. C corporation.
- C. Limited partnership (LP).
- D. Limited liability company (LLC).

Correct Answer: D



## Multiple Choice Question #7:

An accrual-basis taxpayer sold land for \$100,000 on July 1, year 1, and received \$20,000 cash and a note for \$80,000. The taxpayer's basis in the asset is \$60,000. What amount of gain, if any, should the taxpayer report for year 1, if the transaction qualified under the installment sale method?

- A. \$0
- B. \$8,000
- C. \$20,000
- D. \$40,000

Correct Answer: B

## Multiple Choice Question #8:

Lamb purchased real property for \$20,000 and sold it the next year to Gray, Lamb's child, for the fair market value of \$12,000. Later, Gray sold the property to Hogan, who is not related to Gray or Lamb, for \$15,000. What amount, if any, should be recognized by Gray?

- A. \$5,000 loss.
- B. \$3,000 loss.
- C. \$0
- D. \$3,000 gain.

Correct Answer: C

## Multiple Choice Question #9:

Baker made the following gifts: a \$100,000 house to Baker's child, a \$50,000 automobile to a friend, \$40,000 cash to Baker's spouse, and \$60,000 capital stock to a qualified charity. Baker and Baker's spouse do not elect gift splitting. What is the total taxable gift before considering the gift tax annual exclusion?

- A. \$50,000
- B. \$150,000
- C. \$190,000
- D. \$210,000

Correct Answer: B

## Multiple Choice Question #10:

An individual taxpayer had the following transactions during the current year:

Workers' compensation payments	\$30,000
Damages received for slander	40,000
Loss on the sale of a personal residence	75,000
W-2 wages	80,000

What is the taxpayer's adjusted gross income?

- A. \$107,000
- B. \$110,000
- C. \$120,000
- D. \$147,000

Correct Answer: C

## Multiple Choice Question #11:

An individual taxpayer received a Schedule K-1, *Partner's Share of Income, Deductions, Credits, etc.* from a small partnership, in which the taxpayer owns a 50% interest. The qualified business income amount attributable to the taxpayer is \$70,000. That is the taxpayer's only qualified business income, and the taxpayer has no capital gains or other investments. Ignoring the W-2 limitation, what is the net amount of increase to taxable income from the partnership income?

- A. \$0
- B. \$14,000
- C. \$56,000
- D. \$70,000

Correct Answer: C

# Multiple Choice Question #12:

A taxpayer plans to sell the following assets:

- A home rented during the entire year by the taxpayer's tenant at a market rental rate.
- An automobile used by the taxpayer solely for recreational purposes.
- A show dog held by the taxpayer for hobby purposes.
- Common stock held by the taxpayer for investment purposes.

If the taxpayer projects a \$10,000 loss on each asset sale, then the losses will reduce adjusted gross income by what amount?

- A. \$30,000
- B. \$23,000
- C. \$20,000
- D. \$13,000

Correct Answer: D

## Multiple Choice Question #13:

Interest on a tax deficiency begins to accrue on the date on which

- A. The tax was due, without regard to extension of time to file.
- B. The tax was redetermined by the IRS upon audit.
- C. A court decision was entered in favor of the IRS.
- D. A notice of levy was mailed to the taxpayer.

Correct Answer: A

## Multiple Choice Question #14:

As part of a liquidating distribution, a partner receives \$8,000 cash and land with a fair market value of \$12,000 and a basis of \$7,000. The partner's basis in the partnership prior to the distribution was \$10,000. What is the partner's basis in the land immediately after the distribution?

- A. \$2,000
- B. \$7,000
- C. \$8,000
- D. \$12,000

Correct Answer: A



## Multiple Choice Question #15:

In the current year, Anderson, Branch, and Campbell formed Orange Corp. Anderson transferred to the corporation land with an adjusted basis of \$90,000 and a fair market value of \$100,000; Branch transferred to the corporation equipment with an adjusted basis of \$50,000 and a fair market value of \$100,000; and Campbell will render services to the corporation. Each shareholder received 5,000 shares of Orange Corp. stock, worth a total of \$100,000. What amount of income must Campbell report as a result of this transfer?

- A. \$0
- B. \$10,000
- C. \$50,000
- D. \$100,000

Correct Answer: D

## Multiple Choice Question #16:

Peach, Inc. files a consolidated federal income tax return with its 100%-owned domestic subsidiaries. In year 2, members of the consolidated group reported net book income (loss) as follows:

Peach, Inc.	\$ 125,000
Apple, Inc.	45,000
Blueberry, Inc.	(100,000)

Apple paid \$50,000 in dividends to Peach in year 2. The dividends are included in Peach's net income reported above. Based on the information provided, what is the group's consolidated taxable income for year 2?

- A. \$20,000
- B. \$30,000
- C. \$35,000
- D. \$70,000

Correct Answer: A

## Multiple Choice Question #17:

Which of the following shareholders is ineligible to own the stock of an S corporation?

- A. Domestic C corporation.
- B. Resident alien individual.
- C. Estate of a deceased U.S. citizen.
- D. Grantor trust created by a U.S. citizen.

Correct Answer: A

## Multiple Choice Question #18:

Which of the following conditions is sufficient for a partnership to change its otherwise required taxable year?

- A. The partners unanimously agree to a deferral of exactly six months.
- B. By majority vote, the partners agree to a deferral of exactly six months.
- C. The partnership prefers to use a calendar year in order to substantially defer the partners' tax liability.
- D. The partnership makes an election for a different taxable year, which has a deferral of exactly three months.

Correct Answer: D

## Multiple Choice Question #19:

For a not-for-profit organization with unrelated business income, the calculation of the unrelated business income tax is made upon

- A. All income from the organization.
- B. The gross receipts from the unrelated business, less related deductions.
- C. The gross receipts from unrelated business, less related deductions, plus interest and dividends.
- D. The gross receipts from unrelated business, less related deductions and donations of the organization, less program expenses.

Correct Answer: B

## Multiple Choice Question #20:

Which of the following individuals is acting as a tax return preparer under IRS regulations?

- A. A CPA who prepares a substantial portion of a claim for refund of tax for a client.
- B. A CPA who prepares a tax return for a taxpayer under the Volunteer Income Tax Assistance program.
- C. An employee of the tax department of a corporation who prepares a tax return on behalf of the corporation's wholly owned subsidiary.
- D. An employee of the tax department of a corporation who prepares a claim for refund on behalf of the corporation's parent company, which owns 100% of the corporation.

Correct Answer: A

## Multiple Choice Question #21:

A taxpayer received a 90-day letter proposing a deficiency. The taxpayer challenged the proposed deficiency in the Small Cases Division of the U.S. Tax Court. If the taxpayer loses the case, then the decision is

- A.     Appealable to the regular division of the U.S. Tax Court.
- B.     Appealable to the United States District Court if the deficiency is paid.
- C.     Appealable to the U.S. Court of Federal Claims if the deficiency is paid.
- D.     Not appealable.

Correct Answer: D

## Multiple Choice Question #22:

A reportable transaction is one with respect to which additional information is required to be included with a federal income tax return because the transaction is of a type, according to an IRS determination, that has

- A. A significant tax impact in the return year.
- B. The potential for tax avoidance or evasion.
- C. A potential impact on more than one taxpayer.
- D. A significant tax impact on future years' returns.

Correct Answer: B



## Multiple Choice Question #23:

Brasher, who owns an office building, hires a real estate agent to find a buyer for the building. Shortly thereafter, Jaxson hires the same real estate agent to find an office building for purchase. If the agent sells Brasher's office building to Jaxson without disclosing the agency relationship with Brasher, the real estate agent has breached which of the following duties?

- A. Duty to inform.
- B. Duty of due diligence.
- C. Duty of obedience.
- D. Duty of loyalty.

Correct Answer: D

## Multiple Choice Question #24:

Excusing performance of a contract due to very large unforeseen expenses **not** contemplated by the parties to the contract at the time of the formation of the contract is the definition of which of the following?

- A. Tender of performance.
- B. Anticipatory repudiation.
- C. Commercial impracticality.
- D. Impossibility of performance.

Correct Answer: C

## Multiple Choice Question #25:

Funding from FICA contributions is provided to assist qualifying individuals in each of the following groups, **except**

- A. Retirees.
- B. Unemployed workers.
- C. Survivors of deceased workers.
- D. Elderly individuals requiring medical services or hospitalization.

Correct Answer: B

## Multiple Choice Question #26:

Smith owns vacant lot A, with a basis of \$10,000 and a fair market value of \$25,000. Jones owns lot B, with a basis of \$11,000 and a fair market value of \$22,000. Smith and Jones agree to trade lots, with Jones paying Smith \$3,000. After the exchange, what amount is Smith's basis in lot B?

- A. \$7,000
- B. \$10,000
- C. \$11,000
- D. \$22,000

Correct Answer: B

## Multiple Choice Question #27:

A taxpayer received an investment property from a former spouse as a result of a divorce. The former spouse had purchased the property for \$100,000 several years before they got married, and the fair market value of the property was \$175,000 at the time of the divorce. One year after receiving the property, the taxpayer obtained a loan secured by the property in the amount of \$50,000. One year after obtaining the loan, the taxpayer sold the property for \$190,000 and used the proceeds to repay the loan. What amount is the taxpayer's recognized tax gain from the sale of the property?

- A. \$15,000
- B. \$40,000
- C. \$90,000
- D. \$140,000

Correct Answer: C

## Multiple Choice Question #28:

ABC Industries, a C corporation, was incorporated on March 1, year 2, and elected a calendar year end. On April 15, year 2, prior to commencing business operations, ABC purchased the assets of DEF Corp. for \$350,000. Of this amount, \$90,000 was allocated to goodwill. On May 1, year 2, ABC commenced business operations. What amount of goodwill amortization can ABC claim on its year 2 corporate tax return?

- A. \$4,000
- B. \$4,250
- C. \$5,000
- D. \$6,000

Correct Answer: A

## Multiple Choice Question #29:

Emmett loaned Baker \$10,000. Baker filed for bankruptcy last year, and Emmett was notified that Emmett would receive \$0.20 on the dollar. In the current year, Emmett received \$1,500 as the final settlement. The loan is nonbusiness. How should Emmett report the loss?

- A. \$8,000 short-term capital loss last year and \$500 ordinary loss in the current year.
- B. \$8,000 short-term capital loss last year and \$500 capital loss in the current year.
- C. \$8,500 ordinary loss in the current year.
- D. \$8,500 short-term capital loss in the current year.

Correct Answer: D

## Multiple Choice Question #30:

An S corporation pays one of its individual shareholders for services rendered to the S corporation, and a general partnership pays one of its partners for services rendered to the partnership. Which of the following statements is accurate regarding these payments?

- A. The S corporation should classify the payments as deductible wages reportable on Form W-2.
- B. The partnership should classify the payments as deductible wages reportable on Form W-2.
- C. The S corporation should classify the payments as nondeductible dividends reportable on Form 1099-DIV.
- D. The partnership should classify the payments as nondeductible partnership distributions reportable on Form K-1.

Correct Answer: A



# Multiple Choice Question #31:

Which of the following would be treated as passive activity income under the passive activity loss rules?

- A. Dividend income from a taxpayer's investment portfolio.
- B. Income from a taxpayer's limited partnership interest.
- C. Commission received from selling vacation property.
- D. Rental income from real estate in which the taxpayer materially participated as a real estate professional.

Correct Answer: B

## Multiple Choice Question #32:

The spouse of a married taxpayer died on January 15, year 1. The taxpayer's qualifying child moved to live with grandparents in their home on August 30, year 2. If the taxpayer did **not** remarry before the end of year 2, then which filing status should the taxpayer choose for year 2?

- A. Surviving spouse.
- B. Head of household.
- C. Married filing jointly.
- D. Married filing separately.

Correct Answer: B

## Multiple Choice Question #33:

A company reported net income of \$400,000 on its year 2 audited financial statements. The company reported \$240,000 in tax expenses to arrive at its net income for financial statement purposes in year 2, as detailed below:

Federal income tax paid to the IRS	\$150,000
State income tax paid to state Q	50,000
Foreign income tax paid to country M	20,000
Property tax paid to state Q	15,000
Sales tax paid to state Q	5,000

The company will not take the foreign tax credit. What is the company's deduction for taxes paid on its year 2 federal income tax return?

- A. \$70,000
- B. \$90,000
- C. \$170,000
- D. \$240,000

Correct Answer: B

## Multiple Choice Question #34:

A C corporation has a net loss from operations of \$500,000; a long-term capital gain of \$20,000; and a short-term capital loss of \$50,000 for the current year. What is the corporation's loss for the year?

- A. (\$530,000)
- B. (\$500,000)
- C. (\$497,000)
- D. (\$483,000)

Correct Answer: B

## Multiple Choice Question #35:

Chris owns 25%, Tracy owns 35%, and Sam owns 40% of a business that has always been treated as an S corporation for federal income tax purposes. During the current year, \$500,000 of taxable income is generated. Who is responsible for claiming the taxable income?

- A. The corporation.
- B. Chris, Tracy, and Sam, according to their profit distribution agreement.
- C. Chris, Tracy, and Sam, according to their percentage of ownership.
- D. Chris, Tracy, and Sam equally.

Correct Answer: C

## Multiple Choice Question #36:

A C corporation made a proper S election and will be treated as an S corporation as of the first day of year 2. In this case, the corporation is

- A. Subject to built-in gains tax for the 10-year period beginning with the first day of year 2.
- B. Subject to built-in gains tax for the seven-year period beginning with the first day of year 2.
- C. Not subject to built-in gains tax if year 4 is the first year it sells assets that it held as a C corporation.
- D. Not subject to built-in gains tax if year 7 is the first year it sells assets that it held as a C corporation.

Correct Answer: D

## Multiple Choice Question #37:

Lundy, an individual, controls 55% capital interest in a partnership and contributed six acres of land to the partnership. The property had a fair market value of \$41,000. Lundy's basis in the property was \$35,000. Two years later, the partnership sold the land to an unrelated party for \$44,000. What amount of gain on the sale should be allocated to Lundy?

- A. \$1,650
- B. \$2,700
- C. \$4,950
- D. \$7,650

Correct Answer: D

## Multiple Choice Question #38:

Schmitt received \$10,000 cash and an automobile with an adjusted basis of \$15,000 and a fair market value of \$5,000 from a partnership. Schmitt's basis in the partnership before the distribution was \$5,000. What amount, if any, was Schmitt's recognized gain?

- A. \$0
- B. \$5,000
- C. \$10,000
- D. \$20,000

Correct Answer: B



# Simulation #1:

Malin is married and files jointly. Last year, the IRS determined that the couple underpaid their tax liability due to fraud committed by Malin's spouse. What section and subsection of the Internal Revenue Code defines Malin's responsibility for the penalty related to the spouse's fraud?

Enter your response in the answer fields below. Guidance on correctly structuring your response appears above and below the answer fields.

Type the subsection here.

*A correctly formatted IRC subsection is a lower case letter.*

IRC§  ☒ (  ☒ )

**i** Examples of correctly formatted IRC responses are IRC§1(a), IRC§56(a), IRC§25A(a), IRC§162(a), IRC§263A(a), IRC§1245(a), IRC§2032A(a) and IRC§1400Z-1(a).

END OF CONTENT -----

## *Exhibits Information*

*There are no exhibits for this item.*

## *Blueprint Information*

CSO: 001.003.003

Skill: Application

Note: There is no specific representative task associated with research prompts.

# Simulation #2:

Scroll down to complete all parts of this task.

The controller of Oak Corp., a calendar-year-end C corporation, asked you to determine how the sale of various assets should be reported. The controller provided you with the information below for the transactions in year 7. Treat each sale as an independent transaction.

Using the information provided, complete the following table. For each sale in the table below:

- In column B, enter the gain or loss recognized on the sale of the asset. Enter gains as positive, whole values and losses as negative, whole values. If there is no gain or loss, enter a zero (0).
- In column C, click in the cell and select from the option list provided the character of the gain or loss recognized. If there is no gain or loss, select "Not applicable."

	<i>A</i>	<i>B</i>	<i>C</i>
1	Transaction	Gain/loss recognized	Treatment of gain/loss
2	Oak sold 1,000 shares of Rose Corp. stock held for investment on June 15, year 7, for total proceeds of \$10,000. Oak originally purchased 500 shares of Rose Corp. stock on October 10, year 4, for a total cost of \$2,000. On July 15, year 6, there was a 4-for-1 stock split.	123 \$9,000	123 Long-term capital gain/loss
3	Equipment previously used in Oak's business with a useful life of five years for tax purposes was sold on September 20, year 7, for net proceeds of \$45,000. The equipment was originally purchased for \$57,000 on March 1, year 1.	123 \$45,000	123 Ordinary income/loss
4	Inventory was sold on December 15, year 7, for \$8,000. The inventory had a cost basis of \$12,000 and was subsequently written down to \$7,000 only for book purposes on December 31, year 6.	123 (\$4,000)	123 Ordinary income/loss
5	An automobile used in Oak's business was sold for its fair market value of \$15,000 on May 15, year 7, to a shareholder owning 60% of Oak's stock. The automobile was purchased by Oak for \$35,000 on February 1, year 4, and the tax basis on the date of sale was \$22,000.	123 \$0	123 Not applicable

END OF CONTENT -----

-- Option List Details --

- Long-term capital gain/loss
- Ordinary income/loss
- Short-term capital gain/loss
- Not applicable

## *Exhibits Information*

*There are no exhibits for this item.*

## *Blueprint Information*

CSO: 003.001.003

Skill: Application

Representative task: Calculate the amount of ordinary income and loss for federal income tax purposes.

# Simulation #3:

**Scroll down to complete all parts of this task.**

Patel & Company, CPAs, has been engaged to prepare the year 2 Form 1120S, *U.S. Income Tax Return for an S Corporation*, for Woodmere Corp., a calendar-year-end S corporation. Lawrence Black, controller of Woodmere, requested an explanation of the tax implications to both Woodmere and Samantha Diamond, one of the shareholders, resulting from the distribution of undeveloped land to Samantha.

You are a senior accountant with Patel & Company, CPAs, and were asked to review a draft letter prepared by a staff accountant to Woodmere. In addition to the draft letter below, the exhibits above include additional information related to Woodmere and the year 2 distribution of land, which should be used to review the draft letter.

To revise the document, click on each segment of underlined text below and select the needed correction, if any, from the list provided. If the underlined text is already correct, select [Original text] from the list.



**Patel & Company, CPAs**  
**745 Maple Street**  
**Leston, OK 74862**


December 27, year 2


Mr. Lawrence Black, CPA  
Controller  
Woodmere Corp.  
943 Castlewall Avenue  
Leston, OK 74862

Dear Lawrence:


We are responding to your inquiry regarding the tax implications of the year 2 distribution of land to Samantha Diamond, a 50% shareholder in Woodmere Corp. As discussed, Woodmere will not be making any elections regarding the distribution of the land and cash to its shareholders. A summary of how this distribution will impact the year 2 tax returns for both Woodmere and Samantha is included below.


Impact of distribution to Woodmere


We reviewed the documentation related to the land distribution to determine the potential tax ramifications to Woodmere. We have concluded that the distribution of the land to Samantha Diamond will result in the recognition of a tax gain to Woodmere of \$325,000, which will be reported on the year 2 Form 1120S. 

In addition, Woodmere's S corporation status will be immediately terminated, effective retroactively to January 2, year 1, if the fair market value of the land distributed exceeds 50% of the total tax basis of the land plus the anticipated year 2 cash distribution to Isaac. 

Impact of distribution to Samantha Diamond

The distribution of the 10 acres of land will result in a taxable corporate gain to be passed through, and Samantha's respective share will be reported on her year 2 individual tax return. The gain will be reported as a Section 1245 gain. 

Another consideration for this transaction is Samantha's tax basis in the land distributed to her. We have determined that Samantha's tax basis in the 10 acres of land is \$325,000. 

In conjunction with discussing the tax implications of the distribution to Samantha, it is important to determine Samantha's basis in Woodmere. As of January 1, year 2, Samantha's stock basis is \$305,825, before consideration of the distribution of land and year 2 income.  According to our calculations, the distribution will not exceed Samantha's basis at December 31, year 2.

If you have any questions regarding the above information, please contact me.

Sincerely,


Brandon

Brandon Patel, CPA

Patel & Company, CPAs

END OF CONTENT - - - - -

## Response 1

We reviewed the documentation related to the land distribution to determine the potential tax ramifications to Woodmere. We have concluded that the distribution of the land to Samantha Diamond will result in the recognition of a tax gain to Woodmere of \$325,000, which will be reported on the year 2 Form 1120S. 

*Choose an option below*


- ☐ *[Original text]* We have concluded that the distribution of the land to Samantha Diamond will result in the recognition of a tax gain to Woodmere of \$325,000, which will be reported on the year 2 Form 1120S.
- ☐ We have concluded that the distribution of the land to Samantha Diamond will result in the recognition of a tax gain to Woodmere of \$325,000, which will be reported on Samantha's year 2 Schedule K-1.
- ☐ We have concluded that the distribution of the land to Samantha Diamond will result in the recognition of a tax gain to Woodmere of \$200,000, which will be reported on Samantha's year 2 Schedule K-1.
- ☐ We have concluded that the distribution of the land to Samantha Diamond will result in the recognition of a tax gain to Woodmere of \$200,000, which will be reported on the year 2 Form 1120S.

RESET

CANCEL

ACCEPT

## Key

We reviewed the documentation related to the land distribution to determine the potential tax ramifications to Woodmere. **We have concluded that the distribution of the land to Samantha Diamond will result in the recognition of a tax gain to Woodmere of \$200,000, which will be reported on the year 2 Form 1120S.** 

*Choose an option below*


- ☐ *[Original text]* We have concluded that the distribution of the land to Samantha Diamond will result in the recognition of a tax gain to Woodmere of \$325,000, which will be reported on the year 2 Form 1120S.
- ☐ We have concluded that the distribution of the land to Samantha Diamond will result in the recognition of a tax gain to Woodmere of \$325,000, which will be reported on Samantha's year 2 Schedule K-1.
- ☐ We have concluded that the distribution of the land to Samantha Diamond will result in the recognition of a tax gain to Woodmere of \$200,000, which will be reported on Samantha's year 2 Schedule K-1.
- ☒ We have concluded that the distribution of the land to Samantha Diamond will result in the recognition of a tax gain to Woodmere of \$200,000, which will be reported on the year 2 Form 1120S.

RESET

CANCEL

ACCEPT

## Response 2

In addition, Woodmere's S corporation status will be immediately terminated, effective retroactively to January 2, year 1, if the fair market value of the land distributed exceeds 50% of the total tax basis of the land plus the anticipated year 2 cash distribution to Isaac. 

*Choose an option below*

- ☐ *[Original text]* In addition, Woodmere's S corporation status will be immediately terminated, effective retroactively to January 2, year 1, if the fair market value of the land distributed exceeds 50% of the total tax basis of the land plus the anticipated year 2 cash distribution to Isaac.
- ☐ In addition, if the fair value of the property is greater than 20% of the fair market value of the corporation on the date of the distribution, the distribution will terminate Woodmere's S corporation status.
- ☐ In addition, this distribution will not have any impact on Woodmere's S corporation status since you are making an equal distribution of cash to Isaac.
- ☐ In addition, to ensure that you do not inadvertently terminate Woodmere's S corporation status, one-half of the land must be distributed to each shareholder.
- ☐ In addition, you inadvertently terminated Woodmere's S corporation status because you did not make an equal distribution to Isaac at the time the land was distributed to Samantha.

RESET

CANCEL

ACCEPT

## Key

In addition, this distribution will not have any impact on Woodmere's S corporation status since you are making an equal distribution of cash to Isaac. 

*Choose an option below*


- ☐ *[Original text]* In addition, Woodmere's S corporation status will be immediately terminated, effective retroactively to January 2, year 1, if the fair market value of the land distributed exceeds 50% of the total tax basis of the land plus the anticipated year 2 cash distribution to Isaac.
- ☐ In addition, if the fair value of the property is greater than 20% of the fair market value of the corporation on the date of the distribution, the distribution will terminate Woodmere's S corporation status.
- ☒ In addition, this distribution will not have any impact on Woodmere's S corporation status since you are making an equal distribution of cash to Isaac.
- ☐ In addition, to ensure that you do not inadvertently terminate Woodmere's S corporation status, one-half of the land must be distributed to each shareholder.
- ☐ In addition, you inadvertently terminated Woodmere's S corporation status because you did not make an equal distribution to Isaac at the time the land was distributed to Samantha.

RESET

CANCEL

ACCEPT

### Response 3

The distribution of the 10 acres of land will result in a taxable corporate gain to be passed through, and Samantha's respective share will be reported on her year 2 individual tax return. The gain will be reported as a Section 1245 gain. 

*Choose an option below*


- ☐ *[Original text]* The gain will be reported as a Section 1245 gain.
- ☐ The gain will be reported as a Section 1250 gain.
- ☐ The gain will be reported as an unrecaptured Section 1250 gain.
- ☐ The gain will be reported as a capital gain.
- ☐ The gain will be reported as ordinary business income.

RESET

[CANCEL](#)

ACCEPT

### Key

The distribution of the 10 acres of land will result in a taxable corporate gain to be passed through, and Samantha's respective share will be reported on her year 2 individual tax return. The gain will be reported as a capital gain. 

*Choose an option below*

- ☐ *[Original text]* The gain will be reported as a Section 1245 gain.
- ☐ The gain will be reported as a Section 1250 gain.
- ☐ The gain will be reported as an unrecaptured Section 1250 gain.
- ☒ The gain will be reported as a capital gain.
- ☐ The gain will be reported as ordinary business income.


RESET

[CANCEL](#)

ACCEPT



## Response 4

Another consideration for this transaction is Samantha's tax basis in the land distributed to her. We have determined that Samantha's tax basis in the 10 acres of land is \$325,000. 

*Choose an option below*


- ☐ *[Original text]* We have determined that Samantha's tax basis in the 10 acres of land is \$325,000.
- ☐ We have determined that Samantha's tax basis in the 10 acres of land is \$425,000.
- ☐ We have determined that Samantha's tax basis in the 10 acres of land is \$525,000.
- ☐ We have determined that Samantha's tax basis in the 10 acres of land is \$625,000.
- ☐ We have determined that Samantha's tax basis in the 10 acres of land is \$725,000.

RESET

[CANCEL](#)

ACCEPT

## Key

Another consideration for this transaction is Samantha's tax basis in the land distributed to her. **We have determined that Samantha's tax basis in the 10 acres of land is \$525,000.** 

*Choose an option below*


- ☐ *[Original text]* We have determined that Samantha's tax basis in the 10 acres of land is \$325,000.
- ☐ We have determined that Samantha's tax basis in the 10 acres of land is \$425,000.
- ☒ We have determined that Samantha's tax basis in the 10 acres of land is \$525,000.
- ☐ We have determined that Samantha's tax basis in the 10 acres of land is \$625,000.
- ☐ We have determined that Samantha's tax basis in the 10 acres of land is \$725,000.

RESET

[CANCEL](#)

ACCEPT

## Response 5

In conjunction with discussing the tax implications of the distribution to Samantha, it is important to determine Samantha's basis in Woodmere. As of January 1, year 2, Samantha's stock basis is \$305,825, before consideration of the distribution of land and year 2 income. 

*Choose an option below*

- ☐ *[Original text]* Samantha's stock basis is \$305,825, before consideration of the distribution of land and year 2 income.
- ☐ Samantha's stock basis is \$351,875, before consideration of the distribution of land and year 2 income.
- ☐ Samantha's stock basis is \$351,875, and her debt basis is \$1,000,000, before consideration of the distribution of land and year 2 income.
- ☐ Samantha's stock basis is \$251,875, before consideration of the distribution of land and year 2 income.
- ☐ Samantha's stock basis is \$251,875, and her debt basis is \$1,000,000, before consideration of the distribution of land and year 2 income.
- ☐ Samantha's stock basis is \$256,875, before consideration of the distribution of land and year 2 income.
- ☐ Samantha's stock basis is \$256,875, and her debt basis is \$1,000,000, before consideration of the distribution of land and year 2 income.
- ☐ Samantha's stock basis is \$305,825, and her debt basis is \$1,000,000, before consideration of the distribution of land and year 2 income.

RESET

CANCEL

ACCEPT

## Key

In conjunction with discussing the tax implications of the distribution to Samantha, it is important to determine Samantha's basis in Woodmere. As of January 1, year 2, **Samantha's stock basis is \$251,875, before consideration of the distribution of land and year 2 income.** ✓

*Choose an option below*

- ☐ [Original text] Samantha's stock basis is \$305,825, before consideration of the distribution of land and year 2 income.
- ☐ Samantha's stock basis is \$351,875, before consideration of the distribution of land and year 2 income.
- ☐ Samantha's stock basis is \$351,875, and her debt basis is \$1,000,000, before consideration of the distribution of land and year 2 income.
- ☒ Samantha's stock basis is \$251,875, before consideration of the distribution of land and year 2 income.
- ☐ Samantha's stock basis is \$251,875, and her debt basis is \$1,000,000, before consideration of the distribution of land and year 2 income.
- ☐ Samantha's stock basis is \$256,875, before consideration of the distribution of land and year 2 income.

RESET

CANCEL

ACCEPT



## *Exhibits Information*

Exhibits included in  
this item

- 1. Client Letter**
- 2. Attorney Letter**

## Exhibit 1: Client Letter

December 20, year 2

Dear Brandon:

We made a property distribution to Samantha Diamond in year 2 and would like to know the tax implications of the transaction to Woodmere and Samantha. This letter contains background information on Woodmere's formation and the events prior to the distributions.

On January 2, year 1, Woodmere Corp. was formed, and an election was made to be taxed as an S corporation for federal income tax purposes. Woodmere is a retailer of electronic products. Two individuals, Samantha Diamond and Isaac Elwood, each contributed \$150,000 in cash in exchange for 50% stock ownership interests in Woodmere. Also in year 1, Woodmere took out an interest-only \$2,000,000 loan from a local bank with payment due in full on December 31, year 6; both shareholders personally guaranteed payment of this loan. Both Samantha and Isaac actively participate in the management of Woodmere.

On February 1, year 1, Woodmere paid \$325,000 for 10 acres of undeveloped land, on which it planned to construct a distribution warehouse. However, before starting construction, a more suitable location was found with an existing warehouse. The undeveloped land was not used in Woodmere's trade or business. On March 1, year 1, Woodmere entered into a 20-year lease of the existing warehouse and began business.

Information reported to each shareholder on each shareholder's year 1 Schedule K-1, *Shareholder's Share of Income, Deductions, Credits, etc.*, included the following:

Ordinary business income	\$155,825
Interest income	\$1,050
Nondeductible expenses	\$5,000
Cash distribution	\$50,000

On November 3, year 2, the undeveloped land (purchased on February 1, year 1) was distributed to Samantha Diamond. An equivalent cash distribution to Isaac is scheduled to be made before the end of year 2.

Please provide an explanation of the tax implications to both Woodmere and Samantha Diamond resulting from the distribution of undeveloped land.

Sincerely,

Lawrence

Lawrence Black  
Controller

Exhibit 2: Attorney Letter

Davis & Davis, Attorneys at Law

5613 Cedar Avenue  
Leston, OK 74862

November 30, year 2

Ms. Samantha Diamond  
Woodmere Corp.  
943 Castlewall Avenue  
Leston, OK 74862

Dear Samantha:

Enclosed is the deed for 10 acres of land located on Greenston Street in Leston, OK. The transfer of this property to you was recorded with the county on November 3, year 2.

Sincerely,

*Reynaldo*

Reynaldo Davis, Esq.

*Brandon - we have an appraisal for the land dated November 3, year 2, showing a fair market value of \$525,000. Please let me know if you need a copy of this appraisal for your records.*

## *Blueprint Information*

CSO: 005.004.004

Skill: Analysis

Representative task: Analyze the federal income tax implications to the shareholders and the S corporation resulting from shareholder contributions and loans as well as S corporation distributions and loans to shareholders.