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CHAPTER 2 – TAXATION: CORPORATIONS

STUDY MANUAL – REGULATION

OVERVIEW OF CORPORATION INCOME TAX: BASIC FORMULA

A. Overview of Corporation Income Tax: Basic Formula.

1. A regular corporation (also known as a “C” corporation) computes its tax liability as follows:

Corporation Tax Formula (Form 1120)

- a. Gross income (gross revenues).
- b. Less: Exclusions.
- c. Less: Allowable deductions and losses.
- d. Equals: Taxable income.
- e. Step d times tax rate schedules.
- f. Equals: Gross tax liability.
- g. Minus: Estimated tax payments and tax credits.
- h. Plus: Estimated tax penalty.
- i. Equals: Tax due or tax refund.

The format of determining the tax liability follows the format of the tax form [1120 (previous) and 1120A (Form 1120-A no longer allowed beginning January 1, 2007)].

To compute tax liability (step f in formula), the appropriate tax rates are used.

2. Comparison of corporation income tax to individual income tax: The following components of the individual taxation laws *do not apply* to corporations for income tax purposes:
 - a. A subtotal of adjusted gross income (AGI).
 - b. Personal deductions, such as standard deduction or itemized deductions.
 - c. Personal and dependency exemptions.
 - d. Personal tax credits (i.e., child and dependent care credit, earned income credit, credit for the elderly or disabled, adoption expenses credit, education credits, child tax credit, etc.).
3. A regular corporation (also known as a C corporation) must file a Federal Form 1120 tax return by the 15th day of the third month following the close of the taxable year. Thus, a corporation using a calendar year must file by March 15 (rather than April 15, which is the deadline for an individual).
 - a. Most revenues are fully taxable unless specifically designated as nontaxable (such as state and municipal bond interest).

QUESTIONS: LAW: AGENCY

1. Generally, a disclosed principal will be liable to third parties for its agent's unauthorized misrepresentations if the agent is an:

	<u>Employee</u>	<u>Independent contractor</u>
A. Yes	Yes	Yes
B. Yes	No	No
C. No	Yes	Yes
D. No	No	No

2. A principal and agent relationship requires a:
 - A. power of attorney.
 - B. written agreement.
 - C. meeting of the minds and consent to act.
 - D. specified consideration.

3. Noll gives Carr a written power of attorney. Which of the following statements is correct regarding this power of attorney?
 - A. It may continue in existence after Noll's death.
 - B. It must be signed by both Noll and Carr.
 - C. It must be for a definite period of time.
 - D. It may limit Carr's authority to specific transactions.

4. Which of the following statements represent(s) a principal's duty to an agent who works on a commission basis?
 - I. The principal is required to maintain pertinent records, account to the agent, and pay the agent according to the terms of the agreement.
 - II. The principal is required to reimburse the agent for all authorized expenses incurred unless the agreement calls for the agent to pay expenses out of the commission.
 - A. I only.
 - B. Both I and II.
 - C. Neither I nor II.
 - D. II only.

5. Thorp was a purchasing agent for Ogden, a sole proprietor, and had express authority to place purchase orders with Ogden's suppliers. Thorp placed an order with Datz Inc. on Ogden's behalf after Ogden was declared incompetent in a judicial proceeding. Thorp was aware of Ogden's incapacity. Which of the following statements is correct concerning Ogden's liability to Datz?
 - A. Ogden will not be liable because Thorp's agency ended when Ogden was declared incompetent.
 - B. Ogden will be liable because Thorp acted with express authority.
 - C. Ogden will be liable because Datz was not informed of Ogden's incapacity.
 - D. Ogden will not be liable because Ogden was a nondisclosed principal.

ANSWERS: LAW: AGENCY

1. **B** A principal is liable for all torts of their agents if the agent was acting in the scope of their agency. A misrepresentation is a tort, and employees are agents. Thus, a principal is usually liable for misrepresentations of employees. An independent contractor is also an agent of the principal, but because the independent contractor is not subject to the same degree of control by the principal, a principal would generally not be held liable for the unauthorized misrepresentations made by the independent contractor.
2. **C** An agency requires an agreement, a meeting of the minds. The principal gives the agent consent to act.
3. **D** A power of attorney usually limits an agent's authority to specific transactions.
4. **B** Unless otherwise agreed, the principal has a duty to compensate an agent according to the agreement. Where the agreement calls for compensation by commission, a principal would be required to maintain records relating to commissions owed, to account to the agent for such commissions, and to pay the agent. A principal also owes a duty to reimburse an agent for money spent in the principal's service.
5. **A** Death or insanity of either the principal or the agent will end an agency immediately. Once Ogden, the principal, was declared insane, the agency relationship between Thorp and Ogden ended. Because the agency was automatically terminated by operation of law, Ogden would not be liable for the contract.
6. **C** An agent is anyone authorized to act on behalf of another. Minors may be agents, which means statement I is incorrect. An agency relationship is terminated by operation of law if a subject matter that directly relates to the agent's authority is destroyed. Statement II is incorrect because destruction of the collection directly related to the agent's authority to sell and therefore terminated the agency. Post would not be liable because the agency was terminated by operation of law.
7. **D** An agency coupled with an interest cannot be terminated by the principal, but it can be terminated by the agent.
8. **A** If an agent is terminated, a principal must give actual notice to old customers and published notice to new ones. Failure of the principal to give proper notice gives an agent apparent authority to make contracts with customers and subjects the principal to liability. Bolt failed to give published notice of Ace's termination, although they did give notice to old customers. Thus, Ace had apparent authority to make contracts with new customers who were aware that Ace was Bolt's agent. Young (a new customer) knew of Ace, and thus Bolt is liable because their notice was inadequate.
9. **D** When an agent terminates the relationship (in this case by renunciation), the agent still has apparent authority to act on the principal's behalf. This apparent authority would continue until the principal gave actual notice to old customers and published notice to new ones.
10. **C** An agent has implied authority to do what is necessary to accomplish assigned tasks. An accountant and business manager would have the implied authority to insure property against fire loss.
11. **B** Apparent authority depends on how things appear to a third party dealing with the agent. Usually, if it appears the agent was authorized, apparent authority will exist. If a partner's authority was expressly limited by a resolution and the third party knew of the resolution, apparent authority would not exist. The third party would know that the partner's authority was limited.
12. **A** A principal is liable for contracts made by an agent on behalf of the principal if the agent had actual authority or apparent authority. Although Able exceeded her actual authority, Pix can still be liable if Able had apparent authority.