**[Page 7-3, 7-15 & 16]** An owner takes a large salary from her profitable corporation. If the IRS considers the salary to be unreasonably large and treats it as a dividend, it will propose a(an):

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **a.** | Increase the gross income of owner | **b.** | Increase the gross income of corporation |  |
| **c.** | Decrease expense of the corporation | **d.** | Addition of a surtax to tax return of owner |

**[Page 7-3, 7-15 & 16]** The IRS has determined that the $500,000 salary paid by the very profitable Local Corporation (to its president and major stockholder) exceeded reasonable compensation by $200,000. (Please ignore the impact of any change in payroll tax expense.)  
Which amount will not be increased as a result of the likely proposed adjustment by the IRS?

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **a.** | Corporate taxable income | **b.** | Corporate income tax |  |
| **c.** | Individual taxable income |  |  |

Big Corporation, an accrual-basis calendar year corporation, reported net income (GAAP) of $380,000. Included in that amount was $50,000 of interest income from City of Concord Bonds, federal income tax expense of $168,000, North Carolina Income Tax of $26,000, and interest expense of $2,000 on the debt incurred to carry the City of Concord bonds.   
What is Big Corporation's taxable income?

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $500,000 | **b.** | $502,000 | **c.** | $330,000 | **d.** | $310,000 | **e.** | $550,000 |  |  |

For the year ended December 31, 2016, Modern Corp.'s book income, before federal   
income tax, was $100,000. Included in the computation of $100,000 were the following:

|  |  |
| --- | --- |
| Provision for state income tax | $1,000 |
| Interest earned on City of Charlotte Bonds | 6,000 |
| Interest expense on bank loan to purchase City of Charlotte Bonds | 2,000 |
| Entertainment expense (meals for customers) | 1,000 |

Modern's taxable income for 2016 was:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $96,000 | **b.** | $97,000 | **c.** | $96,500 | **d.** | $101,000 |  | (CPA) |  |

A company reported the following GAAP income statement.

|  |  |
| --- | --- |
| Revenue | $950,000 |
| Expenses | (460,000) |
| Net income before income taxes | 490,000 |
| Federal income taxes | (136,000) |
| State income tax | (40,000) |
| Net income (GAAP) | $314,000 |

Expenses include entertainment expense for customers of $30,000. What is taxable income?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $460,000 | **b.** | $465,000 | **c.** | $495,000 | **d.** | 400,000 | **e.** | Other |  |

For the year, Maple Corp.'s book income, before federal income tax, was $100,000.   
Included in this $100,000 were the following:

|  |  |
| --- | --- |
| Provision for state income tax | $1,000 |
| Interest earned on City of Charlotte Bonds | 6,000 |
| Interest expense on bank loan to purchase City of Charlotte Bonds | 2,000 |

Maple's taxable income for the year was:

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $ 96,000 | **b.** | $ 97,000 | **c.** | $ 100,000 | **d.** | $ 101,000 | (CPA-May-1990) |  |

Starke Corp., an accrual-basis calendar year corporation, had net income (GAAP) of $380,000.   
Included in that amount was municipal bond interest income of $50,000, federal income tax   
expense of $170,000, and interest expense of $2,000 on debt incurred to carry the municipal bonds.   
What is Starke's taxable income?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $330,000 | **b.** | $500,000 | **c.** | $502,000 | **d.** | $550,000 |  | CPANov1995 |  |

Elaine spent $1,000 on lunches to entertain her customers at the local country club.   
The club charges an annual membership fee of $800. Elisa uses the facility 80 % of the time for business.   
Her employer does not reimburse her for any of these expenses. What is her deductible expense?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $500 | **b.** | $1,800 | **c.** | $1,640 | **d.** | $1,000 | **e.** | $800 |  |

During the winter holiday season, Taurus Corporation gave 12 business gifts to 12 customers.   
The value of the gifts, which were not of an advertising nature, was as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **2** at $10 | **4** at $25 | **4** at $50 | and | **2** at $100 |

Taurus can deduct as a business expense

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $300 | **c.** | $520 | **d.** | $270 | (CPA) |  |

Walker, an employee of Lakeview Corp., drove his auto 18,000 business miles during 2016.   
He paid tolls of $145 while traveling on business. What amount can Walker deduct as unreimbursed transportation expenses for **2016,** before considering any limits on misc. itemized deductions?

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **a.** | $10,170 for AGI. | **b.** | $10,495 for AGI. |  |
| **c.** | $10,170 from AGI. | **d.** | $9,865 from AGI. |

Penny owns a business and drives her car 12,000 miles a year for business and 3,000 miles a year for commuting and personal use. She wants to claim the largest tax deduction possible for business use of her car. Her total expenses related to her auto for **2016** are as follows:

|  |  |
| --- | --- |
| Gas, oil, and maintenance | $ 3,500 |
| Insurance | 720 |
| Interest on car loan | 500 |
| Depreciation | 3,060 |
| License | 80 |
| Parking fees and tolls (100% business) | 130 |

Penny's **2016** deduction for automobile expense is:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $5,888 | **b.** | $6,018 | **c.** | $6,190 | **d.** | $6,418 | **e.** | $7,010 |  |

Which of the following business expenses is/are subject to a 50% deduction limit for **2016**?

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **a.** | Meals while traveling | **b.** | Lodging while traveling |  |
| **c.** | Both | **d.** | Neither |

Shelly paid $190 to fly from Santa Fe to Denver. She spent three days finalizing a contract   
with the management of El Rancho Restaurant for the delivery of green chili next year.   
Because she finalized the contract, Shelly spent two-days attending the National Western Rodeo. Hotel costs were $108 per night and meals were $22 per day.   
How much can Shelly deduct as business expenses from her trip?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $190 | **b.** | $514 | **c.** | $547 | **d.** | $580 | **e.** | $763 |  |

Celine is a doctor in Little Rock. She traveled to Richmond to attend a two-day seminar for health professionals about investing in real estate. Transportation expenses were $400, the hotel cost $104/day, and meals cost $50/day. How much can Celine deduct for travel to the seminar?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $- 0 - | **b.** | $258 | **c.** | $308 | **d.** | $658 | **e.** | $708 |  |

Robin is an employee of Craftmatic Company. She paid business expenses of $7,500 as follows:

|  |  |
| --- | --- |
| Lodging while on business trip | $ 2,500 |
| Transportation (no commuting) | 3,500 |
| Dues and subscriptions | 1,500 |

Robin receives reimbursement of $5,600 after an adequate accounting to her employer.   
Robin's itemized deductions before any limitations would be:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $ - 0 - | **b.** | $1,500 | **c.** | $1,900 | **d.** | $5,600 | **e.** | $7,500 |  |

Sally is a corporate sales representative for Computer City. Sally receives a monthly travel allowance from Computer City to cover her travel costs (transportation, food, lodging, entertainment, etc.). This month she traveled to Dallas for a business convention and received a reimbursement for the expenses for that trip.  
If Sally is not required to account to Computer City regarding details of the travel reimbursement.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **I.** | | **Sally will not have to show any aspect of the travel reimbursement or expenses incurred on her income tax return if she spends all of the reimbursement on valid travel expenses.** | | | | |
| **II** | | **Sally will only have gross income to the extent her travel allowance exceeds her actual costs.** | | | | |
| **a.** | | Only statement I is correct. | **b.** | Only statement II is correct. |  | |
| **c.** | | Both statements are correct. | **d.** | Neither statement is correct. |  | |

Jim's **business workshop building was totally destroyed by fire.** The property had an adjusted basis of $150,000 and a FMV of $130,000 before the fire. Jim received insurance reimbursement of $120,000 for the loss. Jim's AGI was $70,000, before considering this loss. Jim had no casualty gains during the year. What amount of the **fire loss** was Jim entitled to claim on his tax return?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $ 2,900 | **b.** | $ 8,500 | **c.** | $ 8,600 | **d.** | $10,000 | **e.** | $30,000 |  |

[Text page 1-20] Realty Co. was organized on January 1, year 1.   
Realty bought a building on that date for $400,000, having a 40‑year life with no salvage.   
The straight-line depreciation method is used for the tax return and in the GAAP (accrual basis) financial statements. Depreciation is $10,000 per year on the tax return and in the GAAP statements. Realty rented the building to IBM for 2 years at $25,000 per year.   
Realty received rent of $50,000 from IBM on January 1, year 1 (for Year 1 and Year 2).   
Realty’s income tax rate is 40% for the current year and for future years.   
The year 1 GAAP (accrual basis) income statement is presented below.

|  |  |  |
| --- | --- | --- |
| **GAAP Income Statement and Tax Return** | **GAAP** | **TAX** |
| Rent Revenue | $25,000 |  |
| Depreciation Expense | (10,000) |  |
| Other expenses except income tax | (5,000) |  |
| Net income before income tax | 10,000 |  |
| Income Tax Expense and Tax Payable (40%) | (4,000) |  |
| Net Income and Taxable Income | $6,000 |  |

How much taxable income is reported on the Year 1, accrual basis, federal tax return?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $6,000 | **b.** | $25,000 | **c.** | $35,000 | **d.** | Other |  |

Use information in preceding question.What is the amount of the deferred tax asset or a deferred tax liability at the end of Year 1?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $10,000 | **b.** | $25,000 | **c.** | Cannot determine |  |  |  |

Use information in preceding question.Does Realty Co. have a deferred tax asset or a deferred tax liability at the end of Year 1?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Asset | **b.** | Liability | **c.** | Cannot determine |  |  |  |

**Use the following information for the next four questions.**

[See textbook page 1-20] Great Company collects cash for revenue before that revenue is earned.

* When cash is collected, the company debits cash and credits unearned revenue.
* At the end of each accounting period, the company adjusts the books by moving the appropriate amount from the unearned revenue account to the earned revenue account.

The company provided the following information for 2016.

|  |  |  |
| --- | --- | --- |
| Unearned Revenue | Balance-January 1, 2016 | $20,000 |
| Unearned Revenue | Balance-December 31, 2016 | $30,000 |
| Collection of Revenue | All of 2016 | $100,000 |

**T Accounts for GAAP Entries**

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Amounts in $000 | **Cash** | |  | **Deferred Revenue** | |  | **Earned Revenue** | |
| Beginning Balance |  | Not given |  |  |  |  |  |  |
| Rent collected |  |  |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |
| Adjusting Entry |  |  |  |  |  |  |  |  |
| Ending Balance |  |  |  |  |  |  |  |  |

Assume that Great Company enters into one-year “service contracts” for all of its   
customers, and collects the revenue at the start of the year covered by each contract.   
How much revenue is reported on the federal corporate income tax return for 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $90,000 | **c.** | $100,000 | **d.** | $110,000 | **e.** | Other |  |

Assume that Great Company is in the business of renting office space to local businesses.   
Great Company enters into one-year “rental contracts” for all of its tenants, and collects the revenue at the start of the year covered by each contract.

How much revenue is reported on the federal corporate income tax return for 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $90,000 | **c.** | $100,000 | **d.** | $110,000 | **e.** | Other |  |

Great Company is in the business of renting office space to local businesses.What is the balance in the deferred tax asset or a deferred tax liability at the end of 2016?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $6,000 | **b.** | $10,000 | **c.** | $25,000 | **d.** | $12,000 |  |

Great Company is in the business of renting office space to local businesses.Does Great Company have a deferred tax asset or a deferred tax liability at the end of 2016?

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Asset | **b.** | Liability | **c.** | Cannot determine |  |  |  |

[See page 1-28] Big Corporation pays Sue a salary of $100,000 in 2016.   
On December 31, 2016, Big Corporation notifies Sue that her bonus   
for 2016 is $20,000, which will be paid on January 31, 2017.   
The employer’s 2016 compensation deduction for compensation to Sue is:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **a.** | $120,000 if Sue owns no stock of Big Corporation. |  |  |  |
| **b.** | $120,000 if Sue owns 100%l of the stock of Big Corporation |  |  |  |

Garcia began business this year as a self-employed chiropractor and   
a cash basis taxpayer. This year, he provided patient services totaling $800,000.   
Of that total amount, he estimates $20,000 will never be collected.   
How much can Garcia deduct as a bad debt expense in the current tax year?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $ 0 | **b.** | $ 6,000 | **c.** | $10,000 | **d.** | $14,000 | **e.** | $20,000 |  |

Corporation X, a calendar year accrual basis taxpayer, was short on cash in December, 2016,   
so it accrued [but did not pay] a year-end bonus of $20,000 to the President and   
100% stockholder, and a $10,000 year-end bonus to the Vice-president who owns no stock.   
The bonuses were paid in February, 2017. How much does X corporation deduct?

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  | **For 2016?** | **For 2017?** |  | **For 2016?** | **For 2017?** |  |
| **a.** | $30,000 | $0 | **b.** | $20,000 | $10,000 |
| **c.** | $10,000 | $20,000 | **d.** | $0 | $20,000 |

On October 1, 2016, Malazia, a cash basis taxpayer, signed a 48-month lease for office   
space. Malazia moved in on October 1, 2016 and paid $9,600 rent for the entire lease term.   
For 2016, Malazia can deduct:

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $9,600. | **b.** | $4,800. | **c.** | $1,600. | **d.** | $600. | **e.** | $400. |  |

**Use the information for Guaranty Company for next five questions.**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Guaranty Company - Year 1** | |  | |  | |
| **Cash** |  | **60,000** |  | |
| **Machine - Bought Jan. 2, Year 1** | | **50,000** |  | |
| **Accumulated Depreciation-S.L.- 5 years** | |  | **10,000** | |
| **Warranty Liability** |  |  | **12,000** | |
| **Common Stock** |  |  | **28,000** | |
| **Retained Earnings** |  |  |  | |
| **Repair revenue** |  |  | **200,000** | |
| **Warranty Expense** |  | **18,000** |  | |
| **Salaries, supplies, depreciation, etc.** | | **122,000** |  | |
| **Totals** |  | **250,000** | **250,000** | |

How much was Guaranty’s warranty provision?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| a. | $0 | b. | $6,000 | c. | $12,000 | d. | $18,000 | e. | Other |  |

How much did Guaranty spend on warranty claims?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| a. | $0 | b. | $6,000 | c. | $12,000 | d. | $18,000 | e. | Other |  |

What is Guaranty’s taxable income for the year?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| a. | $0 | b. | $60,000 | c. | $72,000 | d. | $48,000 | e. | Other |  |

What is the balance in Guaranty’s deferred tax asset or liability account at year-end?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| a. | $0 | b. | $6,000 | c. | $12,000 | d. | $4,800 | e. | Other |  |

What is the net amount of Guaranty’s income tax expense reported in the GAAP statements?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| a. | $0 | b. | $24,000 | c. | $28,800 | d. | $19,600 | e. | Other |  |

ABC, Inc. (started in 2015) reported annual sales of $190,000 in 2015, and $200,000 in 2016.   
ABC had GAAP net income before income tax of $40,000 for both 2015 and 2016.   
Each year, the provision for product warranties is equal to 5% of gross sales.   
The warranty liability account balance was $4,000 at the end of 2015 and $3,000 at the end of 2016.   
What is the amount of ABC’s taxable income for 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $40,000 | **b.** | $41,000 | **c.** | $38,000 | **d.** | $39,000 | **e.** | Other |  |

MNO, Inc. was started in 2015. The company provided the following GAAP income   
statement for 2016, which includes all revenue and expense other than federal income tax**.**

|  |  |
| --- | --- |
| Sales | $200,000 |
| Cost of sales | 100,000 |
| Total expenses other than income taxes | 60,000 |

MNO’s provision for bad debts each year (included above) is equal to 4% of gross sales.

|  |  |
| --- | --- |
| Allowance for bad debts, 12/31/2015 | $3,000 |
| Allowance for bad debts, 12/31/2016 | 4,000 |

What is MNO’s taxable income for 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $40,000 | **b.** | $41,000 | **c.** | $38,000 | **d.** | $39,000 | **e.** | Other |  |

Continue preceding question. Assume the only difference the company has had between   
GAAP and Tax accounting is in accounting for bad debts and the income tax rate is 40%.   
What is the balance in the deferred tax account at the end of 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $0 | **b.** | $400 | **c.** | $1,400 | **d.** | $1,600 | **e.** | Other |  |

Continue preceding question. Assume the only difference the company has   
had between GAAP and Tax Accounting is in accounting for bad debts.   
Is the deferred tax account at the end of 2016 an asset or liability?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | Asset | **b.** | Liability | **c.** | Cannot determine |  |  |  |  |  |

For an accrual basis taxpayer, which of the following statements best describes   
the tax treatment of losses from uncollectible business debts?

|  |  |  |  |
| --- | --- | --- | --- |
| **a.** | Such losses are not deductible. | |  |
| **b.** | Such losses are limited to $3,000 per year. |
| **c.** | Such losses are treated as short-term capital losses. |
| **d.** | Such losses are deductible without limitation as an ordinary loss. |

The Charlotte Corporation provides this information at the end of 2016.

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Sales (All on credit) | | | | | |  | | | $100,000 | |
| Expenses other than bad debts | | | | | | | $80,000 | |  | |
| Bad debts (Provision-5% of Sales) | | | | | | | 5,000 | |  | |
| Total Expenses | | | | | | |  | | 85,000 | |
| Net Income before Taxes | | | | | | |  | | $15,000 | |
|  | | | | | | | **Beginning** | | **Ending** | |
| Accounts Receivable | | | | | | | $80,000 | | $ 85,000 | |
| Allowance for Bad Debts | | | | | | | $4,000 | | $ 6,000 | |
| What is Charlotte Corporation’s taxable Income for 2016? | | | | | | | | | | | | | |
| **a.** | | | $15,000 | **b.** | $17,000 | **c.** | $13,000 | | | **d.** | | other |  |  |  |

Repeat the preceding question for the Charlotte Corporation.   
How much cash was collected from customers in 2016?

|  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **a.** | $100,000 | **b.** | $90,000 | **c.** | $95,000 | **d.** | $92,000 |  |  |  |

Repeat the preceding question for the Charlotte Corporation.   
At the end of 2016, Charlotte Corporation will include in its GAAP financial statements:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **a.** | deferred tax asset | **b.** | deferred tax liability |  |