McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

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McGraw Hills Taxation of Business Entities 2021 Edition 12th Edition by Spilker CH01

ANSWERS ARE LOCATED IN THE SECOND PART OF THIS DOCUMENT

TRUE/FALSE - Write 'T' if the statement is true and 'F' if the statement is false.

1) The Internal Revenue Code authorizes deductions for trade or business activities if the expenditure is "ordinary and necessary."

◎ true
◎ false

2) Business activities are distinguished from personal activities in that business activities are motivated by the pursuit of profits.

◎ true
◎ false

3) The phrase "ordinary and necessary" has been defined to mean that an expense must be essential and indispensable to the conduct of a business.

◎ true
◎ false

4) Reasonable in amount means that expenditures can be exorbitant as long as the activity is motivated by profit.

◎ true
◎ false

5) The test for whether an expenditure is reasonable in amount is whether the expenditure was for an "arm's length" amount.

◎ true
◎ false

6) Illegal bribes and kickbacks are not deductible as business expenses but fines imposed by a governmental unit are deductible as long as the fines are incurred in the ordinary course of business.

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

◎ true
◎ false

7) Although expenses associated with illegal activities are not deductible, political contributions can be deducted as long as the donation is not made to a candidate for public office.

◎ true
◎ false

8) When a taxpayer borrows money and invests the loan proceeds in municipal bonds, the interest paid by the taxpayer on the debt will not be deductible.

◎ true
◎ false

9) A business can deduct the cost of uniforms supplied to employees.

◎ true
◎ false

10) Only half the cost of a business meal is deductible even if the meal is extravagant.

◎ true
◎ false

11) Taxpayers must maintain written contemporaneous records of business purpose when traveling in order to claim a deduction for the expenditures.

◎ true
◎ false

12) Ralph borrowed $4 million and used the proceeds in his Internet business. The interest on this debt is not subject to an interest limitation if Ralph's business has average annual gross receipts of $26 million or less for the prior three taxable years.

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

◎ true
◎ false

13) Adjusted taxable income for calculating the business interest limitation is defined as taxable income of the taxpayer computed without regard to any item of income, gain, deduction, or loss that is not properly allocable to a trade or business.

◎ true
◎ false

14) The deduction for business interest expense is limited to the sum of (1) business interest income and (2) 30 percent of the adjusted taxable income of the taxpayer for the taxable year.

◎ true
◎ false

15) The deduction for business interest expense is limited in 2020 to the sum of (1) business interest income and (2) 40 percent of the adjusted taxable income of the taxpayer for the taxable year.

◎ true
◎ false

16) A loss deduction from a casualty of a business asset is only available if the asset is completely destroyed.

◎ true
◎ false

17) All taxpayers must account for taxable income using a calendar year.

◎ true
◎ false

18) A short tax year can end on any day of any month other than December.

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

◎ true
◎ false

19) A fiscal tax year can end on the last day of any month other than December.

◎ true
◎ false

20) A business generally adopts a fiscal or calendar year by using that year-end on the first tax return for the business.

◎ true
◎ false

21) Sole proprietorships must use the same tax year as the proprietor of the business.

◎ true
◎ false

22) Even a cash-method taxpayer must consistently use accounting methods that "clearly reflect income" for tax purposes.

◎ true
◎ false

23) The 12-month rule allows taxpayers to deduct the entire amount of certain prepaid business expenses.

◎ true
◎ false

24) The all-events test for income determines the period in which income will be recognized for tax purposes.

◎ true
◎ false

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

25) The full-inclusion method requires cash-basis taxpayers to include prepayments for goods or services into realized income.

◎ true
◎ false

26) Uniform capitalization of indirect inventory costs is required for mostvery large taxpayers.

◎ true
◎ false

MULTIPLE CHOICE - Choose the one alternative that best completes the statement or answers the question.

27) Individual proprietors report their business income and deductions on:

A) Form 1065.
B) Form 1120S.
C) Schedule C.
D) Schedule A.
E) Form 1041.

28) According to the Internal Revenue Code §162, deductible trade or business expenses must be which one of the following?

A) Incurred for the production of investment income
B) Ordinary and necessary
C) Minimized
D) Appropriate and measurable
E) Personal and justifiable

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29) Which of the following expenditures is NOT likely to be allowed as a current deduction for a landscaping and nursery business?

A) Cost of fertilizer
B) Accounting fees
C) Cost of a greenhouse
D) Cost of uniforms for employees
E) A cash settlement for trade name infringement

30) The IRS would most likely apply the arm's length transaction test to determine which of the following?

A) Whether an expenditure is related to a business activity.
B) Whether an expenditure will be likely to produce income.
C) Timeliness of an expenditure.
D) Reasonableness of an expenditure.
E) All of the choices are correct.

31) Which of the following business expense deductions is most likely to be unreasonable in amount?

A) Compensation paid to the taxpayer's spouse in excess of salary payments to other employees.
B) Amounts paid to a subsidiary corporation for services where the amount is in excess of the cost of comparable services by competing corporations.
C) Cost of a meal with a former client when there is no possibility of any future benefits from a relation with that client.
D) All of the choices are likely to be unreasonable in amount.
E) None of the choices are likely to be unreasonable in amount.

32) Which of the following is a true statement?

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

A) Interest expense is not deductible if the loan is used to purchase municipal bonds.
B) Insurance premiums are not deductible if paid for "key-employee" life insurance.
C) One-half of the cost of business meals is not deductible.
D) All of these choices are true.
E) None of the choices are true.

33) Which of the following expenditures is most likely to be deductible for a construction business?

A) A fine for a zoning violation.
B) A tax underpayment penalty.
C) An "under the table" payment to a government representative to obtain a better price for raw materials.
D) A contribution to the mayor's political campaign fund.
E) An arm's length payment to a related party for emergency repairs of a sewage line.

34) Which of the following is an explanation for why insurance premiums on a key employee are not deductible?

A) A deduction for the insurance premium would offset taxable income without the potential for the proceeds generating taxable income.
B) The federal government does not want to subsidize insurance companies.
C) It is impractical to trace insurance premiums to the receipt of proceeds.
D) Congress presumes that all expenses are not deductible unless specifically allowed in the Internal Revenue Code.
E) This rule was grandfathered from a time when the Internal Revenue Code disallowed all insurance premiums deductions.

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

35) Paris operates a talent agency as a sole proprietorship, and this year she incurred the following expenses in operating her talent agency. What is the total deductible amount of these expenditures?

$1,000 dinnerand theater with a film producer where no business was discussed
$500 lunch with sister Nicky where no business was discussed
$700 business dinner with a client but Paris forgot to keep any records (oops!)
$900 tickets to the opera with a client following a business meeting

A) $450
B) $900
C) $1,100
D) $1,200
E) $0

36) Dick pays insurance premiums for his employees. What type of insurance premium is not deductible as compensation paid to the employee?

A) Health insurance with benefits payable to the employee.
B) Whole life insurance with benefits payable to the employee's dependents.
C) Group-term life insurance with benefits payable to the employee's dependents.
D) Key-employee life insurance with benefits payable to Dick.
E) All of the choices are deductible by Dick.

37) Which of the following is a true statement?

A) Meals are never deductible as a business expense.
B) An employer can only deduct half of any meals provided to employees as compensation.
C) The cost of business meals must be reasonable.
D) A taxpayer can only deduct a meal for a client if business is discussed during the meal.
E) None of the choices are true.

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

38) In order to deduct a portion of the cost of a business meal, which of the following conditions must be met?

A) A client (not a supplier or vendor) must be present at the meal.
B) The taxpayer or an employee must be present at the meal.
C) The meal must occur on the taxpayer's business premises.
D) None of these choices is a condition for the deduction.
E) All of the choices are conditions for a deduction.

39) Which of the following is likely to be a business expense fully deductible in the current year?

A) Salaries in excess of the industry average paid to attract talented employees.
B) The cost of employee uniforms that can be adapted to ordinary personal wear.
C) A speeding fine paid by a trucker who was delivering a rush order.
D) The cost of a three-year subscription to a business publication.
E) None of the choices are likely to be deductible.

40) Holly took a prospective client to dinner, and after agreeing to a business deal, they went to the theater. Holly paid $290 for the meal andseparately paid $250 for the theater tickets, amounts that were reasonable under the circumstances. What amount of these expenditures can Holly deduct as a business expense?

A) $540
B) $270
C) $145
D) $125
E) None—the meals and entertainment are not deductible except during travel.

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

41) Holly took a prospective client to dinner, and after agreeing to a business deal, they went to the theater. Holly paid $480 for the meal and separately paid $174 for the theater tickets, amounts that were reasonable under the circumstances. What amount of these expenditures can Holly deduct as a business expense?

A) $654
B) $327
C) $240
D) $87
E) None—the meals and entertainment are not deductible except during travel.

42) This year Clark leased a car to drive between his office and various work sites. Clark carefully recorded that he drove the car 23,000 miles this year and paid $7,200 of operating expenses ($2,700 for gas, oil, and repairs, and $4,500 for lease payments). What amount of these expenses may Clark deduct as business expenses?

A) $7,200
B) Clark cannot deduct these costs because taxpayers must use the mileage method to determine any transportation deduction.
C) $4,500
D) $2,700
E) Clark is not entitled to any deduction if he used the car for any personal trips.

43) Shelley is self-employed in Texas and recently attended a two-day business conference in New Jersey. After Shelley attended the conference, she had dinner with an old friend who lived nearby. Shelley documented her expenditures (described below). What amount can Shelley deduct?

Airfare to New Jersey	$ 2,000
Meals at the conference	220
Meal with an old friend	120
Lodging in New Jersey	450
Rental car	180

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

A) $2,850
B) $2,740
C) $1,850, if Shelley itemizes the deductions
D) All of these expenses are deductiblebut only if Shelley attends a conference in Texas.
E) None of the expenses are deductible because Shelley visited her friend.

44) Shelley is self-employed in Texas and recently attended a two-day business conference in New Jersey. After Shelley attended the conference, she had dinner with an old friend who lived nearby. Shelley documented her expenditures (described below). What amount can Shelley deduct?

Airfare to New Jersey	$ 2,100
Meals at the conference	230
Meal with an old friend	126
Lodging in New Jersey	440
Rental car	190

A) $2,960
B) $2,845
C) $1,910, if Shelley itemizes the deductions
D) All of these expenses are deductible but only if Shelley attends a conference in Texas.
E) None of the expenses are deductible because Shelley visited her friend.

45) Which of the following is a true statement?

A) Meals, lodging, and incidental expenditures are deductible if the taxpayer is away from home overnight while traveling.
B) Meals are deductible for an employee who is forced to work during the lunch hour.
C) When a taxpayer travels solely for business purposes, only half of the costs of travel are deductible.
D) If travel has both business and personal aspects, the cost of transportation is always deductible but the deductibility of lodging depends upon whether business is conducted that day.
E) None of the choices are true because business travel is not deductible.

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

46) Which of the following is a true statement about travel that has both business and personal aspects?

A) Transportation costs are always fully deductible.
B) Meals are not deductible for this type of travel.
C) Only half of the cost of meals and transportation is deductible.
D) Thededuction for the cost of lodging and incidental expenditures is limited to those amounts incurred during the business portion of the travel.
E) None of the choices are correct.

47) John is a self-employed computer consultant who lives and works in Dallas. John paid for the following activities in conjunction with his business. Whichof the following expenditures is not deductible in any amount?

1.Dinner with a potential client where the client's business was discussed.
2.A trip to Houston to negotiate a contract.
3.A seminar in Houston on new developments in the software industry.
4.A trip to New York to visit a school chum who is also interested in computers.

A) 1 only
B) 2 only
C) 3 only
D) 4 only
E) None of the choices are correct.

48) Which of the following expenditures is completely deductible?

A) $1,000 spent on compensating your brother for a personal expense.
B) $50 spent on meals while traveling on business.
C) $2,000 spent by the employer on reimbursing an employee for entertainment.
D) All of these expenses are fully deductible.
E) None of these expenses can be deducted in full.

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

49) Ed is a self-employed heart surgeon who lives in Michigan and has incurred the following reasonable expenses. How much can Ed deduct?

$1,000 in airfare to repair investment rental property in Colorado.
$500 in meals while attending a medical convention in New York.
$300 for tuition for an investment seminar, "How to pick stocks."
$100 for tickets to a football game with hospital administrators to celebrate successful negotiation of a surgical contract earlier in the day.

The correct answer is _____.

A) $1,250 "for AGI"
B) $1,300 "for AGI" and $300 "from AGI"
C) $480 "for AGI"
D) $80 "for AGI" and $1,300 "from AGI"
E) None of the choices are correct.

50) Ed is a self-employed heart surgeon wholives in Michigan and has incurred the following reasonable expenses. How much can Ed deduct?

$1,210 in airfare to repair investment rental property in Colorado.
$600 in meals while attending a medical convention in New York.
$350 for tuition for an investment seminar, "How to pick stocks."
$138 for tickets to a football game with hospital administrators to celebrate successful negotiation of a surgical contract earlier in the day.

The correct answer is _____.

A) $1,510 "for AGI"
B) $1,560 "for AGI" and $369 "from AGI"
C) $549 "for AGI"
D) $118 "for AGI" and $1,560 "from AGI"
E) None of the choices are correct.

51) Ronald is a cash-method taxpayer who made the following expenditures this year. Which expenditure is completely deductible in this period as a business expense?

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

A) $4,000 for rent on his office, which covers the next 24 months.
B) $3,000 for a new watch for the mayor to keep "good relations" with city hall.
C) $2,500 for professional hockey tickets distributed to a customer to generate "goodwill" for his business.
D) $55 to collect an account receivable from a customer who has failed to pay for services rendered.
E) None of the choices are completely deductible.

52) George operates a business that generated revenues of $50 million and allocable taxable income of $1.25 million. Included in the computation of allocable taxable income were deductible expenses of $240,000 of business interest and $250,000 of depreciation. What is the maximum business interest deduction that George will be eligible to claim this year?

A) $375,000
B) $522,000
C) $1,500,000
D) $300,000
E) $228,000

53) George operates a business thatin 2020 generated revenues of $50 million and allocable taxable income of $560,000. Included in the computation of allocable taxable income were $900,000 of business interest expense, $20,000 of business interest income, and $180,000 of depreciation. What is the maximum business interest deduction that George will be eligible to claim this year?

A) $168,000
B) $222,000
C) $280,000
D) $830,000
E) $880,000

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

54) George operates a business that generated revenues of $61 million and allocable taxable income of $1.36 million. Included in the computation of allocable taxable income were deductible expenses of $245,500 of business interest and $255,500 of depreciation. What is the maximum business interest deduction that George will be eligible to claim this year?

A) $408,000
B) $558,300
C) $1,615,500
D) $331,350
E) $257,700

55) George operates a business that in 2020 generated revenues of $50 million and allocable taxable income of $750,000. Included in the computation of allocable taxable income were $909,500 of business interest expense, $29,500 of business interest income, and $189,500 of depreciation.Assume CARES Act applies. What is the maximum business interest deduction that George will be eligible to claim this year?

A) $225,000
B) $93,750
C) $151,750
D) $939,250
E) $989,250

56) Which of the following is a true statement about the limitation on business interest deductions?

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

A) Interest disallowed by this limitation is carried back three years and then forward five years.

B) The limitation is calculated as a percentage of the taxpayer's total taxable income.

C) This limitation is not imposed on businesses with average annual gross receipts of $26 million or less for the prior three taxable years.

D) All of the choices are false.

E) All of the choices are true.

57) Adjusted taxable income is defined as follows for purposes of the business interest limitation:

A) taxable income allocable to the business computed without regard to interest income; depreciation, amortization, or depletion; interest expense; and net operating loss deductions.

B) 30 percent of revenue after deducting depreciation and interest expense.

C) taxable income allocable to debt invested in the business.

D) interest income after deducting 30 percent of all deductible expenses.

E) None of the choices are correct.

58) For purposes of the business interest limitation, adjusted taxable income is defined as taxable income allocable to the business computed without regard to which of the following:

A) interest income, depreciation, amortization, or depletion; interest expense; and net operating loss deductions.

B) 30 percent of revenue after deducting depreciation and interest expense.

C) Debt invested in the business.

D) interest income after deducting 30 percent of all deductible expenses.

E) None of the choices are correct.

59) Riley operates a plumbing business, and this year the three-year-old van he used in the business was destroyed in a traffic accident. The van was originally purchased for $20,000 and the adjusted basis was $5,800 at the time of the accident. Although the van was worth $6,000 at the time of accident, insurance only paid Riley $1,200 for the loss. What is the amount of Riley's casualty loss deduction?

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

A) $6,000
B) $14,000
C) $5,800
D) $4,600
E) $5,300

60) Riley operates a plumbing business, and this year the three-year-old van he used in the business was destroyed in a traffic accident. The van was originally purchased for $22,000 and the adjusted basis was $5,550 at the time of the accident. Although the van was worth $6,200 at the time of accident, insurance only paid Riley $1,450 for the loss. What is the amount of Riley's casualty loss deduction?

A) $6,200
B) $15,800
C) $5,550
D) $4,100
E) $5,150

61) Don operates a taxi business, and this year one of his taxis was damaged in a traffic accident. The taxi was originally purchased for $32,000 and the adjusted basis was $2,000 at the time of the accident. The taxi was repaired at a cost of $2,500 and insurance reimbursed Don $700 of this cost. What is the amount of Don's casualty loss deduction?

A) $1,300
B) $2,500
C) $1,800
D) $2,000
E) Don is not eligible for a casualty loss deduction

62) Don operates a taxi business, and this year one of his taxis was damaged in a traffic accident. The taxi was originally purchased for $20,000 and the adjusted basis was $1,200 at the time of the accident. The taxi was repaired at a cost of $2,900 and insurance reimbursed Don $748 of this cost. What is the amount of Don's casualty loss deduction?

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

A) $452
B) $2,900
C) $2,152
D) $1,200
E) Don is not eligible for a casualty loss deduction

63) Which of the following cannot be selected as a valid tax year-end?

A) December 31st
B) January 31st
C) The last Friday of the last week of June
D) December 15th
E) A tax year can end on any of these days.

64) Bill operates a proprietorship using the cash method of accounting, and this year he received the following:

- $100 in cash from a customer for services rendered this year
- a promisefrom a customer to pay $200 for services rendered this year
- tickets to a football game worth $250 as payment for services performed last year
- a check for $170 for services rendered this year that Bill forgot to cash

How much income should Bill realize on Schedule C?

A) $100
B) $300
C) $350
D) $270
E) $520

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

65) Bill operates a proprietorship using the cash method of accounting, and this year he received the following:

- $170 in cash from a customer for services rendered this year
- a promise from a customer to pay $186 for services rendered this year
- tickets to a football game worth $215 as payment for services performed last year
- a check for $184 for services rendered this year that Bill forgot to cash

How much income should Bill realize on Schedule C?

A) $170
B) $356
C) $385
D) $354
E) $569

66) Clyde operates a sole proprietorship using the cash method. This year, Clyde made the following expenditures:

$480 to U.S. Bank for 12 months of interest accruing on a business loan from September 1 of this year through August 31 of next year even though only $160 of interest accrued this year.
$600 for 12 months of property insurance beginning on July 1 of this year.

What is the maximum amount Clyde can deduct this year?

A) $760
B) $600
C) $480
D) $160
E) $360

67) Beth operates a plumbing firm. In August of last year, she signed a contract to provide plumbing services for a renovation. Beth began the work that August and finished the work in December of last year. However, Beth didn't bill the client until January of this year and she didn't receive the payment until March when she received payment in full. When should Beth recognize income under the accrual method of accounting?

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

A) In August of last year
B) In December of last year
C) In January of this year
D) In March of this year
E) In April of this year

68) Jim operates his business on the accrual method, and this year, he received $4,000 for services that he intends to provide to his clients next year. Under what circumstances can Jim defer the recognition of the $4,000 of income until next year?

A) Jim can defer the recognition of the income if he absolutely promises not to provide the services until next year.
B) Jim must defer the recognition of the income until the income is earned.
C) Jim can defer the recognition of the income if he has requested that the client not pay for the services until the services are provided.
D) Jim can elect to defer the recognition of the income if the income is not recognized for financial accounting purposes.
E) Jim can never defer the recognition of the prepayments of income.

69) When does the all-events test under the accrual method require the recognition of income from the sale of goods?

A) when the title of the goods passes to the buyer
B) when the business receives payment
C) when payment is due from the buyer
D) the earliest of the other three dates
E) None of the choices are correct.

70) Colbert operates a catering service on the accrual method. In November of year 1, Colbert received a payment of $9,000 for 18 months of catering services to be rendered from December 1 st of year 1 through May 31 stof year 3. When must Colbert recognize the income if his accounting methods are selected to minimize income recognition?

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

A) $500 is recognized in year 1, $6,000 in year 2, and $2,500 in year 3.
B) $500 is recognized in year 1 and $8,500 in year 2.
C) $9,000 is recognized in year 3.
D) $2,500 is recognized in year 1 and $6,500 in year 2.
E) $9,000 is recognized in year 1.

71) Which of the following types of transactions may not be accounted for using the cash method for small proprietorships?

A) Sales of inventory
B) Services
C) Sales of securities by an investor
D) Payments of debt
E) All of the choices can be accounted for using the cash method.

72) Which of the following types of expenditures is not subject to capitalization under the UNICAP rules?

A) Selling expenditures
B) Cost of manufacturing labor
C) Compensation of managers who supervise production
D) Cost of raw materials
E) All of the choices are subject to capitalization under the UNICAP rules

73) Kip started a wholesale store this year selling bulk peanut butter. In January of this year, Kip purchased an initial five tubs of peanut butter for a total cost of $5,000. In July, Kip purchased three tubs for a total cost of $6,000. Finally, in November Kip bought two tubs for a total cost of $1,000. Kip sold six tubs by year-end. What is Kip's ending inventory under the FIFO cost-flow method?

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

A) $12,000
B) $6,000
C) $5,000
D) $2,500
E) $1,000

74) Mike started a calendar-year business on September 1st of this year by paying 12 monthsof rent on his shop at $1,000 per month. What is the maximum amount of rent that Mike can deduct this year under each type of accounting method?

A) $12,000 under the cash method and $12,000 under the accrual method
B) $4,000 under the cash method and $12,000 under the accrual method
C) $12,000 under the cash method and $4,000 under the accrual method
D) $4,000 under the cash method and $4,000 under the accrual method
E) $4,000 under the cash method and zero under the accrual method

75) Mike started a calendar-year business on September 1st of this year by paying 12 months of rent on his shop at $850 per month. What is the maximum amount of rent that Mike can deduct this year under each type of accounting method?

A) $10,200 under the cash method and $10,200 under the accrual method
B) $3,400 under the cash method and $10,200 under the accrual method
C) $10,200 under the cash method and $3,400 under the accrual method
D) $3,400 under the cash method and $3,400 under the accrual method
E) $3,400 under the cash method and zero under the accrual method

76) Which of the following is a payment liability?

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

A) Tort claims
B) Refunds
C) Insurance premiums
D) Real estate taxes
E) All of the choices are correct

77) Joe is a self-employed electrician who operates his business on the accrual method. This year Joe purchased a shop for his business, and for the first time at year-end he received a bill for $4,500 of property taxes on his shop. Joe didn't pay the taxes until after year-end but prior to filing his tax return. Which of the following is a true statement?

A) If he elects to treat the taxes as a recurring item, Joe can accrue and deduct $4,500 of taxes on the shop this year.
B) The taxes are a payment liability.
C) The taxes would not be deductible if Joe's business was on the cash method.
D) Unless Joe makes an election, the taxes are not deductible this year.
E) All of the choices are true.

78) Brad operates a storage business on the accrual method. On July 1, Brad paid $48,000 for rent on his storage warehouse and $18,000 for insurance on the contents of the warehouse. The rent and insurance cover the next 12 months. What is Brad's deduction for the rent and insurance?

A) $48,000 for the rent and $18,000 for the insurance
B) $24,000 for the rent and $18,000 for the insurance
C) $24,000 for the rent and $9,000 for the insurance
D) $48,000 for the rent and $9,000 for the insurance
E) None of the choices are correct.

McGraw Hills Taxation of Business Entities 2021 Edition 12th edition Spilker Test Bank

79) Ajax Computer Company is an accrual-method calendar-year taxpayer. Ajax has never advertised in the national media prior to this year. In November of this year, however, Ajax paid $1 million for television advertising time during a "super" sporting event scheduled to take place in early February of next year. In addition, in November of this year the company paid $500,000 fora one-time advertising blitz during a professional golf tournament in April of next year. What amount of these payments, if any, can Ajax deduct this year?

A) $1 million
B) $500,000
C) $1.5 million
D) $1.5 million only if the professional golf tournament is played before April 15
E) No deduction can be claimed this year

80) Ajax Computer Company is an accrual-method calendar-year taxpayer. Ajax has never advertised in the national media prior to this year. In November of this year, however, Ajax paid $1.6 million for television advertising time during a "super" sporting event scheduled to take place in early February of next year. In addition, in November of this year the company paid $1,100,000 for a one-time advertising blitz during a professional golf tournament in April of next year. What amount of these payments, if any, can Ajax deduct this year?

A) $1.60 million
B) $1.10 million
C) $2.70 million
D) $2.70 million only if the professional golf tournament is played before April 15
E) No deduction can be claimed this year

81) Big Homes Corporation is an accrual-method calendar-year taxpayer that manufactures and sells modular homes. This year, for the first time Big Homes was forced to offer a rebate on the purchase of new homes. At year-end, Big Homes had paid $12,000 in rebates and was liable for an additional $7,500 in rebates to buyers. What amount of the rebates, if any, can Big Homes deduct this year?

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A) $12,000 because rebates are payment liabilities.
B) $19,500 because Big Homes is an accrual-method taxpayer.
C) $19,500 if this amount is not material, Big Homes expects to continue the practice of offering rebates in future years, and Big Homes expects to pay the accrued rebates before filing its tax return for this year.
D) $12,000 because the $7,500 liability is not fixed and determinable.
E) Big Homes is not entitled to a deduction because rebates are against public policy.

82) Big Homes Corporation is an accrual-method calendar-year taxpayer that manufactures and sells modular homes. This year, for the first time Big Homes was forced to offer a rebate on the purchase of new homes. At year-end, Big Homes had paid $12,900 in rebates and was liable for an additional $7,950 in rebates to buyers. What amount of the rebates, if any, can Big Homes deduct this year?

A) $12,900 because rebates are payment liabilities.
B) $20,850 because Big Homes is an accrual-method taxpayer.
C) $20,850 if this amount is not material, Big Homes expects to continue the practice of offering rebates in future years, and Big Homes expects to pay the accrued rebates before filing its tax return for this year.
D) $12,900 because the $7,950 liability is not fixed and determinable.
E) Big Homes is not entitled to a deduction because rebates are against public policy.

83) Jones operates an upscale restaurant and he pays experienced cooks $35,000 per year. This year, he hired his son as an apprentice cook. Jones agreed to pay his son $40,000 per year. Which of the following is a true statement about this transaction?

A) Jones will be allowed to deduct $40,000 only if his son eventually develops into an expert cook.
B) Jones will be allowed to accrue $40,000 only if he pays his son in cash.
C) Jones will be allowed to deduct $35,000 as compensation and another $5,000 can be deducted as an employee gift.
D) Jones is not entitled to any business deduction until the son is an experienced cook.
E) None of the choices are true.

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84) Jones operates an upscale restaurant and he pays experienced cooks $37,500 per year. This year, he hired his son as an apprentice cook. Jones agreed to pay his son $42,000 per year. Which of the following is a true statement about this transaction?

A) Jones will be allowed to deduct $42,000 only if his son eventually develops into an expert cook.
B) Jones will be allowed to accrue $42,000 only if he pays his son in cash.
C) Jones will be allowed to deduct $37,500 as compensation and another $4,500 can be deducted as an employee gift.
D) Jones is not entitled to any business deduction until the son is an experienced cook.
E) None of the choices are true.

85) Manley operates a law practice on the accrual method and calendar year. At the beginning of the year, Manley's firm had an allowance for doubtful accounts with a balance of $15,000. At the end of the year, Manley recorded bad debt expense of $23,000 and the balance of doubtful accounts had increased to $18,000. What is Manley's deduction for bad debt expense this year?

A) $23,000
B) $3,000
C) $26,000
D) $5,000
E) $20,000

86) Manley operates a law practice on the accrual method and calendar year. At the beginning of the year, Manley's firm had an allowance for doubtful accounts with a balance of $14,100. At the end of the year, Manley recorded bad debt expense of $21,400 and the balance of doubtful accounts had increased to $19,600. What is Manley's deduction for bad debt expense this year?

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A) $21,400
B) $5,500
C) $26,900
D) $1,800
E) $15,900

87) Which of the following is NOT considered a related party for the purpose of limitation on accruals to related parties?

A) Spouse when the taxpayer is an individual.
B) A partner when the taxpayer is a partnership.
C) Brother when the taxpayer is an individual.
D) A minority shareholder when the taxpayer is a corporation.
E) All of these are related parties.

88) Which of the following is a true statement about accounting for business activities?

A) An overall accounting method can only be adopted with the permission of the commissioner.
B) An overall accounting method is initially adopted on the first return filed for the business.
C) The cash method can only be adopted by individual taxpayers.
D) The accrual method can only be adopted by corporate taxpayers.
E) None of the choices are true.

89) Which of the following is a true statement about impermissible accounting methods?

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A) An impermissible method is adopted by using the method to report results for two consecutive years.

B) An impermissible method may never be used by a taxpayer.

C) Cash-method accounting is an impermissible method for partnerships and Subchapter S– electing corporations.

D) There is no accounting method that is impermissible.

E) None of the choices are true.

90) Todd operates a business using the cash basis of accounting. At the end of last year, Todd was granted permission to switch his sales on account to the accrual method. Last year, Todd made $420,000 of sales on account, and $64,000 was uncollected at the end of the year. What is Todd's §481 adjustment for this year?

A) Increase income by $420,000

B) Increase income by $16,000

C) Increase expenses by $64,000

D) Increase expenses by $420,000

E) Todd has no §481 adjustment this year.

91) Todd operates a business using the cash basis of accounting. At the end of last year, Todd was granted permission to switch his sales on account to the accrual method. Last year, Todd made $421,500 of sales on account, and $64,600 was uncollected at the end of the year. What is Todd's §481 adjustment for this year?

A) Increase income by $421,500

B) Increase income by $16,150

C) Increase expenses by $64,600

D) Increase expenses by $421,500

E) Todd has no &sect481 adjustment this year.

92) Which of the following is a true statement about a request for a change in accounting method?

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A) Some requests are automatically granted.
B) Most requests require the permission of the commissioner.
C) Many requests require payment of a fee and a good business purpose for the change.
D) Form 3115 is typically required to be filed with a request for change in accounting method.
E) All of the choices are true.

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

93) Smith operates a roof repair business. This year, Smith's business generated cash receipts of $32,000, and Smith made the following expenditures associated with his business:

Advertising	$ 500
Car and truck expenses	1,360
Depreciation	3,200
Employee compensation	5,000
Education	1,000

The education expense was for a two-week, nighttime course in business management. Smith believes the expenditure should qualify as an ordinary and necessary business expense. What net income should Smith report from his business? Smith is on the cash method and calendar year.

94) Smith operates a roof repair business. This year, Smith's business generated cash receipts of $32,660, and Smith made the following expenditures associated with his business:

Advertising	$ 535
Car and truck expenses	1,332
Depreciation	3,222
Employee compensation	5,175
Education	1,700

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The education expense was for a two-week, nighttime course in business management. Smith believes the expenditure should qualify as an ordinary and necessary business expense. What net income should Smith report from his business? Smith is on the cash method and calendar year.

95) Bryon operates a consulting business and he usually works alone. However, during the summer Bryon will sometimes hire undergraduate students to collect data for his projects. This past summer Bryon hired Fred, the son of a prominent businessman, for a part-time summer job. The summer job usually pays about $17,000, but Bryon paid Fred $27,000 to gain favor with Fred's father. What amount of Fred's summer wages can Bryon deduct for tax purposes? Bryon is on the cash method and calendar year.

96) Bryon operates a consulting business and he usually works alone. However, during the summer Bryon will sometimes hire undergraduate students to collect data for his projects. This past summer Bryon hired Fred, the son of a prominent businessman, for a part-time summer job. The summer job usually pays about $17,300, but Bryon paid Fred $28,200 to gain favor with Fred's father. What amount of Fred's summer wages can Bryon deduct for tax purposes? Bryon is on the cash method and calendar year.

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97) Werner is the president and CEO of Acme, Incorporated, and this year, he took a prospective client to dinner. During the dinner, Werner and the client discussed a proposed contract for over $6 million as well as personal matters. After dinner, Werner took the client to a football game and no business was discussed. Werner paid $1,220 for an expensive(but not extravagant) dinner and spent $600 for tickets to the game. What is the deductible amount of these expenses?

98) Crystal operates a business that provides typing and delivery services. This year, Crystal spent $2,500 to purchase special shirts that identify her employees and provide some notoriety for her business. The shirts are especially colorful and include logos on the front pocket and the back. Besides salary payments, Crystal also compensates her employees by offering to pay whole life insurance premiums for any that want to provide insurance coverage for their beneficiaries. This year, Crystal paid $5,000 in life insurance premiums. What amount of these payments can Crystal deduct? Crystal is on the cash method and calendar year.

99) Crystal operates a business that provides typing and delivery services. This year, Crystal spent $2,680 to purchase special shirts that identify her employees and provide some notoriety for her business. The shirts are especially colorful and include logos on the front pocket andthe back. Besides salary payments, Crystal also compensates her employees by offering to pay whole life insurance premiums for any that want to provide insurance coverage for their beneficiaries. This year, Crystal paid $5,900 in life insurance premiums. What amount of these payments can Crystal deduct? Crystal is on the cash method and calendar year.

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100) Judy is a self-employed musician who performs for a variety of events. This year, Judy was fined $250 by the city for violating the city's noise ordinance with a relatively loud performance. As a consequence, Judy contributed $1,000 to a campaign committee formed to recall the city's mayor. Judy normally hires three part-time employees to help her schedule events and transport equipment. Judy paid a total of $33,000 to her employees through June of this year. In June, Judy fired her part-time employees and hired her husband to replace them. However, Judy paid him $55,000 rather than $33,000. Judy is on the cash method and calendar year, and she wants to know what amount of these expenditures is deductible as business expenses.

101) Judy is a self-employed musician who performs for a variety of events. This year, Judy was fined $285 by the city for violating the city's noise ordinance with a relatively loud performance. As a consequence, Judy contributed $930 to a campaign committee formed to recall the city's mayor. Judy normally hires three part-time employees to help her schedule events and transport equipment. Judy paid a total of $33,700 to her employees through June of this year. In June, Judy fired her part-time employees and hired her husband to replace them. However, Judy paid him $54,300 rather than $33,700. Judy is on the cash method and calendar year, and she wants to know what amount of these expenditures is deductible as business expenses.

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102) Danny owns an electronics outlet in Dallas. This year, he paid $600 to register for a four-day course in management in Chicago. Danny paid $800 in airfare and $1,000 for five nights' lodging. After the course, Danny spent the last day sightseeing. During the trip, Danny also paid $140 a day for meals, and $80 a day for a rental car. What amount of these travel expenditures may Danny deduct as business expenses?

103) Danny owns an electronics outlet in Dallas. This year, he paid $670 to register for a four-day course in management in Chicago. Danny paid $730 in airfare and $720 for five nights' lodging. After the course, Danny spent the last day sightseeing. During the trip, Danny also paid $280 a day for meals, and $220 a day for a rental car. What amount of these travel expenditures may Danny deduct as business expenses?

104) Sam operates a small chain of pizza outlets in Fort Collins, Colorado. In November of this year, Sam decided to attend a two-day management training course. Sam could choose to attend the course in Denver or Los Angeles. Sam decided to attend the course in Los Angeles and take an eight-day vacation immediately after the course. Sam reported the following expenditures from the trip:

Course Tuition	$ 2,500
Airfare	800
Hotel (10 nights)	1,200
Rental car (10 days)	900
Meals (10 days)	1,500

What amount of travel expenditures can Sam deduct?

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105) Sam operates a small chain of pizza outlets in Fort Collins, Colorado. In November of this year, Sam decided to attend a two-day management training course. Sam could choose to attend the course in Denver or Los Angeles. Sam decided to attend the course in Los Angeles and take an eight-day vacation immediately after the course. Sam reported the following expenditures from the trip:

Course Tuition	$ 2,725
Airfare	860
Hotel (10 nights)	1,800
Rental car (10 days)	840
Meals (10 days)	2,100

What amount of travel expenditures can Sam deduct?

106) Gabby operates a pizza delivery service. This year, she paid delivery personnel $18,000 in salary. She carefully documented the business use of the auto (11,700 miles this year), and her $7,350 of vehicle expenses (for gas, oil, repairs, and auto lease payments). What amount of these expenses may Gabby deduct as business expenses? Gabby is on the cash method and calendar year.

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107) Alvin is a self-employed sound technician who reports on the cash method and calendar year. Alvin has a shop in Austin, Texas, but he spends much of his time away from his shop traveling to and from various concerts around the country. Alvin leases a truck to move his equipment around the country, and this year, he spent $12,000 in lease payments and paid $18,000 for gas, oil, and repairs. Alvin keeps records of his personal use of the truck and he estimates that 6,000 of the total 36,000 miles put on the truck this year were for personal trips. What amount of these expenses may Alvin deduct as business expenses?

108) Sandy Bottoms Corporation generated taxable income (before depreciation, interest expense, and any tax loss carryovers) of $3 million this year. Taxable income included $75,000,000 of revenue and $350,000 of interest income. What is Sandy Bottoms's domestic maximum interest expense deduction for the year?

109) Sandy Bottoms Corporation generated taxable income (before depreciation, interest expense, and any tax loss carryovers) of $3 million in 2020. Taxable income included $75,000,000 of revenue and $350,000 of interest income. What is Sandy Bottoms's domestic maximum interest expense deduction for the year?

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110) Sandy Bottoms Corporation generated taxable income (before depreciation, interest expense, and any tax loss carryovers) of $3 million this year. Taxable income included $75,013,000 of revenue and $356,500 of interest income. What is Sandy Bottoms's domestic maximum interest expense deduction for the year?

111) Sandy Bottoms Corporation generated taxable income (before depreciation, interest expense, and any tax loss carryovers) of $3 million in 2020. Taxable income included $75,003,000 of revenue and $351,500 of interest income. What is Sandy Bottoms's maximum interest expense deduction for the year?

112) Rock Island Corporation generated taxable income (before deductions for depreciation, interest expense, and net operating loss carryovers) of $1 million this year. Taxable income was computed on $50 million of revenues and included $50,000 of interest income. The company paid $450,000 in interest expense. What is Rock Island's maximum business interest deduction for the year?

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113) Rock Island Corporation generated taxable income (before deductions for depreciation, interest expense, and net operating loss carryovers) of $1 million in 2020. Taxable income was computed on $50 million of revenues and included $50,000 of interest income. The company paid $450,000 in interest expense. What is Rock Island's maximum business interest deduction for the year?

114) Rock Island Corporation generated taxable income (before deductions for depreciation, interest expense, and net operating loss carryovers) of $3 million this year. Taxable income was computed on $50 million of revenues and included $130,000 of interest income. The company paid $454,000 in interest expense. What is Rock Island's maximum business interest deduction for the year?

115) Rock Island Corporation generated taxable income (before deductions for depreciation, interest expense, and net operating loss carryovers) of $3 million in 2020. Taxable income was computed on $50 million of revenues and included $150,000 of interest income. The company paid $455,000 in interest expense. What is Rock Island's maximum business interest deduction for the year?

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116) Otto operates a bakery and is on the cash method and calendar year. This year, one of Otto's ovens caught fire and was partially destroyed. Otto bought it a few years ago for $20,000 and claimed depreciation of $12,000 up to the fire. Otto was charged $4,400 for repairs to the oven but the insurance company paid Otto $1,500 for the damage. What is Otto's casualty loss deduction?

117) Otto operates a bakery and is on the cash method and calendar year. This year, one of Otto's ovens caught fire and was partially destroyed. Otto bought it a few years ago for $29,000 and claimed depreciation of $13,800 up to the fire. Otto was charged $3,500 for repairs to the oven but the insurance company paid Otto $1,950 for the damage. What is Otto's casualty loss deduction?

118) David purchased a deli shop on February 1st of last year and began to operate it as a sole proprietorship. David reports his personal taxes using the cash method over a calendar year, and he wants to use the cash method and fiscal year for his sole proprietorship. He has summarized his receipts and expenses through January 31st of this year as follows:

	Receipts	Expenses
February through December last year	$ 112,000	$ 84,500
January this year	10,400	6,200

What income should David report from his sole proprietorship?

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119) David purchased a deli shop on February 1st of last year and began to operate it as a sole proprietorship. David reports his personal taxes using the cash method over a calendar year, and he wants to use the cash method and fiscal year for his sole proprietorship. He has summarized his receipts and expenses through January 31st of this year as follows:

	Receipts	Expenses
February through December last year	$ 112,200	$ 84,200
January this year	10,600	6,400

What income should David report from his sole proprietorship?

120) Marilyn operates a day care center as a cash-method sole proprietorship. On August 1st of this year, Marilyn received a prepayment of $4,000 for child care services to be rendered evenly over the next 20 months. How much income must Marilyn recognize this year if she is attempting to minimize her tax burden?

121) Mike operates a fishing outfitter as an accrual-method sole proprietorship. On March 1st of this year, Mike received $15,000 for three outfitting trips. This is the first time Mike agreed to such a payment and he is obligated to outfit one trip per year for the next three summers, beginning this year. How much income must Mike recognize in each of the next three years if he is attempting to minimize his tax burden?

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122) Mike operates a fishing outfitter as an accrual-method sole proprietorship. On March 1st of this year, Mike received $15,600 for five outfitting trips. This is the first time Mike agreed to such a payment and he is obligated to outfit one trip per year for the next five summers, beginning this year. How much income must Mike recognize in each of the next five years if he is attempting to minimize his tax burden?

123) Anne is a self-employed electrician who reports her business income using the accrual method over a calendar year. On September 1st of this year, Anne paid $2,280 of interest on a loan. The interest accrues evenly over 19 months ($120 per month) from June 1st of this year through December 31st of next year. In addition, on September 1st Anne also paid $2,700 for 18 months of professional liability insurance ($150 per month). What amount of interest and insurance can Anne deduct this year?

124) Anne is a self-employed electrician who reports her business income using the accrual method over a calendar year. On September 1st of this year, Anne paid $2,751 of interest on a loan. The interest accrues evenly over 21 months ($131 per month) from June 1st of this year through December 31st of next year. In addition, on September 1st Anne also paid $3,220 for 20 months of professional liability insurance ($161 per month). What amount of interest and insurance can Anne deduct this year?

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125) Bob operates a clothing business using the accrual method over a calendar year. In October of last year, Bob contracted with his father, Tim, for consulting advice. Tim is a cash-basis calendar-year taxpayer, and he billed Bob for $6,000 of consulting fees. This amount was comparable to amounts charged by other consultants (a reasonable amount). Bob paid $2,500 of the consulting fee by December 31st of last year, but the remaining $3,500 was not paid until January of this year. When can Bob deduct the consulting fee?

126) Colby Motors uses the accrual method and reports on a calendar year. In December of last year, Colby acquired auto repair equipment. As part of the acquisition, Colby purchased a warranty agreement that requires the seller of the equipment to provide repairs on the equipment for three years. Colby paid the cost of the warranty, $15,000, in January of this year. What can Colby deduct for the cost of the warranty on the tax return for last year?

127) Ranger Athletic Equipment uses the accrual method and reports on a calendar year. Ranger provides two-year warranties on all sales of equipment. This year, Ranger estimated warranty expense for book purposes, and he accrued $1 million of warranty expenses. However, during the year Ranger only spent $400,000 repairing equipment under the warranty. What can Ranger deduct for warranty expense on the tax return for this year?

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128) Blackwell Manufacturing uses the accrual method and reports on a calendar year. This year, a customer was injured when visiting the Blackwell factory. The customer sued the company for $500,000, and the case is still being litigated. However, Blackwell's attorney expects that the company will pay at least $250,000 to settle the claim. What amount, if any, can Blackwell deduct for the expected claim settlement this year?

129) Joe operates a plumbing business that uses the accrual method and reports on a calendar year. This year, Joe signed a $50,000 binding contract with Brian. Under the contract, Brian will provide Joe with up to 2,000 hours of vehicle repairs at $25 per hour. This year, Brian provided 200 hours of repair services and billed Joe for $5,000. At year-end, Joe had not paid Brian for the services. What amount, if any, can Joe deduct for the repair services this year?

130) Shadow Services uses the accrual method and reports on a calendar year. This year, Shadow agreed to a uniform-cleaning contract with Odie Cleaning. Under the contract, Odie bills Shadow for cleaning services as the services are provided. At year-end, Shadow paid Odie $2,350 for the services rendered during the year. In addition, Shadow paid Odie $700 for cleaning services expected in January of next year. What amount, if any, can Shadow deduct for the cleaning services this year?

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131) Murphy uses the accrual method and reports on a calendar year. This year, Murphy signed a binding contract to provide consulting services to Kirby beginning next year. Murphy incurred $15,000 to train his staff for this particular project. In addition, Murphy estimates that he will incur another $60,000 to complete the Kirby contract. What amount, if any, can Murphy deduct this year for the services expected to be rendered next year?

132) Taffy Products uses the accrual method and reports on a calendar year. On July 1st of this year Taffy paid $48,000 for warehouse rent and $18,000 for insurance on the contents of its warehouse. The rent and insurance cover the next 12 months. What amount, if any, can Taffy deduct for rent and insurance this year?

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Answer Key

Test name: CH01

1) TRUE
2) TRUE
3) FALSE
A necessary expense is an expense that is helpful or conducive to the business activity.

4) FALSE
5) TRUE
6) FALSE
No deductions are allowed for expenditures that are against public policy.

7) FALSE
8) TRUE
9) TRUE
10) FALSE
11) TRUE
12) TRUE
13) FALSE
14) TRUE
15) FALSE
16) FALSE
17) FALSE
18) FALSE
19) TRUE
20) TRUE

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21) TRUE
22) TRUE
23) TRUE
24) TRUE
25) FALSE
26) TRUE
27) C
28) B
This is language from the IRC.

29) C
A greenhouse is likely to be capitalized rather than deducted as an ordinary and necessary business expense.

30) D
Arm's length is the test used to determine whether an expenditure is reasonable or exorbitant in amount.

31) D
All three situations involve suspicious payments to a related taxpayer orpayments with personal benefits.

32) D
The deduction of each of the above expenditures is either limited or prohibited altogether.

33) E
All of the other alternatives are against public policy.

34) A
Expenses associated with the production of tax-exempt income are not deductible.

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35) E
To deduct the cost of meals associated with an entertainment activity, the cost of the meal must be identified separately from the cost of the entertainment. In all events, only half of the meal expense can be deducted.

36) D
Since the life insurance proceeds are not included in Dick's income, the premiums are classified as an expense associated with the production of tax-exempt income.

37) C
Employee meals can be fully deductible as compensation, and meals merely need to be associated with the conduct of business.

38) B
The taxpayer or employee must be present for a portion of the cost of the meal to be deductible.

39) A
The fine is against public policy, the three-year subscription must be amortized, and uniforms are only deductible if not adaptable to ordinary wear.

40) C
The cost of entertainment is not deductible ($290 × 50% = $145).

41) C
The cost of entertainment is not deductible ($480 × 50% = $240).
42) A
The costs are deductible and prorated between business and personal use. Alternatively, in lieu of deducting these costs, Clark may simply deduct a standard amount for the business mileage.

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43) B

44) B

45) A

When the travel has both business and personal aspects, the deductibility of the transportation costs depends upon whether business is the primary purpose for the trip. If the primary purpose of a trip is business, the transportation costs are fully deductible, but meals (50 percent), lodging, and incidental expenditures are limited to thosecosts incurred during the business portion of the travel.

46) D

Mixed-motive travel is prorated between business and personal elements.

47) D

Thevisit to the school chum does not appear to be business related.

48) E

Business meals are only 50 percent deductible and entertainment is not deductible.

49) A

The investment seminar and entertainment are not deductible, and only 50 percent of the meal cost is deductible [$1,000 airfare + ($500 × 50% = $250 meals) = $1,250 total deduction].

50) A

The investment seminar and entertainment are not deductible, and only 50percent of the meal cost is deductible [$1,210 airfare + ($600 × 50% = $300 meals) = $1,510 total deduction].

51) D

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The rent is prepaid and must be amortized, the watch is a bribe, the gift is too expensive for deduction, and although a cash-method taxpayer cannot deduct bad debts, amounts paid to collect those receivables are fully deductible as an ordinary and necessary business expense.

52) B
($1,250,000 + 240,000 + 250,000) × 30% = $522,000. Note that George can only deduct the interest that was actually paid.
53) D
($560,000 + 900,000 − 20,000 + 180,000) = $1,620,000 $1,620,000 × 50% = $810,000 $810,000 + $20,000 = $830,000. Note that George can never deduct more than the interest that was actually paid.
54) B
($1,360,000 + 245,500 + 255,500) × 30% = $558,300. Note that George can only deduct the interest that was actually paid.
55) D
($750,000 + 909,500 − 29,500 + 189,500) = $1,819,500 $1,819,500 × 50% = $909,750. $909,750 + $29,500 = $939,250. Note that George can never deduct more than the interest that was actually paid.
56) C
Small businesses are not subject to the limitation.

57) A
Adjusted taxable income is allocable and computed without regard to depreciation or amortization

58) A
Adjusted taxable income is computed without regard to interest income or expense, depreciation or amortization, and net operating losses.

59) D
Adjusted basis less insurance reimbursement ($5,800 − $1,200).

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60) D
Adjusted basis less insurance reimbursement ($5,550 − $1,450).
61) A
Lesser of adjusted basis or decline in value (repair cost) less insurance reimbursement (Lesser of $2,500 or $2,000 = $2,000 − $700 = $1,300).

62) A
Lesser of adjusted basis or decline in value (repair cost) less insurance reimbursement (Lesser of $2,900 or $1,200 = $1,200 − $748 = $452).
63) D
December 15 will not qualify for a fiscal or a 52/53-week year.

64) E
Income is realized as property is received, but the promise to pay is not property ($100 + $250 + $170 = $520).

65) E
Income is realized as property is received, but the promise to pay is not property ($170 + $215 + $184 = $569).
66) A
$160 + $600 = $760. The interest can only be deducted as it accrues, so only $160 is deductible. However, all of the insurance payment can be deducted under the 12-month rule because the insurance does not extend beyond the end of next year.

67) B
The income is earned when the all-events test is satisfied on the earliest of the date that the service is provided, the service is billed, orthe payment is received.

68) D

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The deferral method can be elected for advance payments of unearned service income if the income is also unearned for financial reporting.

69) D
The definition of all-events is when the right to income is fixed and determinable on the earliest of the three dates listed.

70) B
Prepayments for services can be deferred for one year if the payments are also unearned for financial reporting purposes. ($9,000 ÷ 18) × 1 month = $500.

71) E
Sales of inventory need not be accounted for using the accrual method if the taxpayer has average annual gross receipts of $26 million or less for the prior three taxable years.

72) A
Selling, advertising, and research expenditures are not subject to UNICAP.

73) C
Kip had $12,000 of goods available for sale. Under the FIFO method, he sold all five tubs from January ($5,000) and one of the tubs from July ($2,000). Hence, his ending inventory consisted of $5,000 (two tubs from July, $4,000, plus both tubs from November, $1,000). Note that taxpayers (other than tax shelters) with average annual gross receipts of $26 million or less over the three prior tax years can elect to use the cash method of accounting for the purchase, production, or sale of merchandise.

74) C

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Mike can deduct 12 months of rent under the cash method by applying the 12-month rule, whereas only four months of rent will accrue because economic performance occurs ratably.

75) C
Mike can deduct 12 months of rent under the cash method by applying the 12-month rule, whereas only four months of rent will accrue because economic performance occurs ratably.
76) E
This is a list of payment liabilities.

77) E
Joe can elect to deduct the taxes accruing this year or he can elect to deduct them as recurring items. If neither election is made, then Joe deducts them in the year paid.

78) B
Economic performance occurs for the rent ratably over time, so only $24,000 is accrued ($2,000 per month). Insurance is a payment liability and accrues only as paid. However, since the payment spans two periods (six months this year and six months next year), the portion benefiting the future period would typically be capitalized. In this case, the duration of the contract does not exceed 12 months and the payment does not extend beyond the end of next year. So, the 12-month rule allows for the deduction of $18,000. Note that the 12-month rule cannot apply to the rent until economic performance occurs, and this only happens ratably.

79) A

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Deduct $1 million, because under the three-and-a-half-month rule payment for a service qualifies as economic performance when actual performance (the service) is expected within three and a half months of the date of payment. Note that the $500,000 might also be deductible if it qualified as a recurring expense if Ajax committed to the ad campaign in future years.

80) A

Deduct $1.60 million, because under the three-and-a-half-month rule payment for a service qualifies as economic performance when actual performance (the service) is expected within three and a half months of the date of payment. Note that the $1,100,000 might also be deductible if it qualified as a recurring expense if Ajax committed to the ad campaign in future years.

81) C

This is the definition of a recurring item—not material in amount (or better matching), expected to recur in the future, and paid before the earlier of eight and a half months or the time the tax return is filed.

82) C

This is the definition of a recurring item—not material in amount (or better matching), expected to recur in the future, and paid before the earlier of eight and a half months or the time the tax return is filed.

83) E

It is likely that Jones will be able to deduct something less than $35,000 as compensation. The remaining compensation will be unreasonable in amount. The compensation will only be deductible in the period in which Jones actually pays his son. Also, gifts are not deductible.

84) E

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It is likely that Jones will be able to deduct something less than $37,500 as compensation. The remaining compensation will be unreasonable in amount. The compensation will only be deductible in the period in which Jones actually pays his son. Also, gifts are not deductible.

85) E

The $23,000 recorded as bad debt expense for financial accounting purposes would have increased the allowance account; however, since the allowance increased $3,000, actual write-offs were $20,000.

86) E

The $21,400 recorded as bad debt expense for financial accounting purposes would have increased the allowance account; however, since the allowance increased $5,500, actual write-offs were $15,900.

87) D

Family members, shareholders, C corporations if the shareholder owns more the 50 percent of the corporation's stock, and owners of partnerships and S corporations.

88) B

An overall accounting method (cash or accrual) is initially adopted with the first return filed for the business.

89) A

A permissible method is adopted by using the method for one year.

90) B

Todd has a positive §481 adjustment of $64,000, and this year only one-quarter of the adjustment ($16,000) must be recognized.

91) B

Todd has a positive §481 adjustment of $64,600, and this year only one-quarter of the adjustment ($16,150) must be recognized.

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92) E

All of these reflect true statements about requests for changes in accounting method.

93) $20,940 = $32,000 − $11,060.

All of the expenses are typical ordinary and necessary expenditures.

94) $20,696 = $32,660 − $11,964.

All of the expenses are typical ordinary and necessary expenditures.

95) $17,000

Only $17,000 is deductible, and the remaining $10,000 is either unreasonable in amount or against public policy (as a bribe).

96) $17,300

Only $17,300 is deductible, and the remaining $10,900 is either unreasonable in amount or against public policy (as a bribe).

97) $610 = 50% × ($1,220).

The meal is 50 percent deductible but the entertainment is not deductible.

98) $7,500.

Uniforms are deductible if not adaptable to normal wear (as would be the case with colorful logo shirts), and life insurance premiums (if not key-employee policies) are deductible as compensation.

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99) $8,580.

Uniforms are deductible if not adaptable to normal wear (as would be the case with colorful logo shirts), and life insurance premiums (if not key-employee policies) are deductible as compensation.

100) $66,000.

The fine and political contribution are not deductible, asthey are against public policy. The compensation of $33,000 for the part-time employees is deductible. Wages paid to her husband of $33,000 would also be deductible. However, the additional wages of $22,000 would appear to be excessive and therefore not deductible.

101) $67,400.

The fine and political contribution are not deductible, as they are against public policy. The compensation of $33,700 for the part-time employees is deductible. Wages paid to her husband of $33,700 would also be deductible. However, the additional wages of $20,600 would appear to be excessive and therefore not deductible.

102) $2,800 = $600 + $800 + (4 nights × $200) + [4 × ($140 × ½)] + (4 × $80).

The trip is primarilyfor business so the airfare is completely deductible. Only four days' cost can be deducted for the lodging, half the meals, and auto rental.

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103) $3,416 = $670 + $730 + (4 nights × $144) + [4 × ($280 × ½)] + (4 × $220)

The trip is primarily for business so the airfare is completely deductible. Only four days' cost can be deducted for the lodging, half the meals, and auto rental.

104) $3,070 = 2,500 + (2 × $120) + (2 × $90) + [2 × (½ × $150)].

The trip is primarily personal so the airfare is not deductible. Only two days' cost can be deducted for the lodging, half the meals, and auto rental.

105) $3,463 = $2,725 + (2 × $180) + (2 × $84) + [2 × (½ × $210)].

The trip is primarily personal so the airfare is not deductible. Only two days' cost can be deducted for the lodging, half the meals, and auto rental.

106) $25,350.

$25,350 = $18,000 salary plus $7,350 for transportation. Note that for transportation Gabby can deduct $6,727.50 (57.5¢ a mile in 2020 × 11,700) or she can choose to deduct actual costs of $7,350.

107) $25,000 = (30/36 × [$18,000 + $12,000]) or $17,250 = (30,000 × 57.5¢ per mile in 2020).

Alvin can claim a proportionate amount of expenses or use the mileage rate.

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108) $1,145,000 = $350,000 + [30% × ($3,000,000 − $350,000)].

The interest deduction is limited to interest income plus 30 percent of allocable taxable income (before depreciation and interest expense) of $3 million less interest income.

109) $1,675,000 = $350,000 + [50% × ($3,000,000 − $350,000)].

The business interest deduction in 2020 is limited to interest income plus 50 percent of allocable taxable income (before depreciation and interest expense) of $3 million less interest income.

110) $1,188,550 = $356,500 + [30% × ($3,130,000 − $356,500)].

The interest deduction is limited to interest income plus 30percent of allocable taxable income (before depreciation and interest expense) of $3.13 million less interest income.

111) $1,690,750 = $351,500 + [50% × ($3,030,000 − $351,500)].

The business interest deduction in 2020 is limited to interest income plus 50percent of allocable taxable income (before depreciation and interest expense) of $3.03 million less interest income.

112) $335,000 = $50,000 + [30% × ($1,000,000 − $50,000)].

The business interest deduction is the amount of interest income plus 30 percent of the taxable income computed without regard to (1) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business; (2) any business interest expense or business interest income; (3) the amount of any net operating loss deduction; and (4) deductions allowable for depreciation, amortization, or depletion.

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113) $525,000 = $50,000 + [50% × ($1,000,000 − $50,000)].

The business interest deduction for 2020 is the amount of interest income plus 50 percent of the taxable income computed without regard to (1) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business; (2) any business interest expense or business interest income; (3) the amount of any net operating loss deduction; and (4) deductions allowable for depreciation, amortization, or depletion.

114) $871,000 = $130,000 + [30% × ($2,600,000 − $130,000)].

The business interest deduction is the amount of interest income plus 30percent of the taxable income computed without regard to (1) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business; (2) any business interest expense or business interest income; (3) the amount of any net operating loss deduction; and (4) deductions allowable for depreciation, amortization, or depletion.

115) $1,575,000 = $150,000 + [50% × ($3,000,000 − $150,000)].

The business interest deduction for 2020 is the amount of interest income plus 50percent of the taxable income computed without regard to (1) any item of income, gain, deduction, or loss that is not properly allocable to a trade or business; (2) any business interest expense or business interest income; (3) the amount of any net operating loss deduction; and (4) deductions allowable for depreciation, amortization, or depletion.

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116) ($2,900) = $1,500 − $4,400.

If a business asset is damaged but not completely destroyed, the amount of the loss is the amount of the insurance proceeds ($1,500) minus the lesser of (1) the asset's adjusted basis of $8,000 ($20,000 − $12,000) or (2) the decline in the value of the asset due to the casualty (repairs) of $4,400.

117) ($1,550) = $1,950 − $3,500.

If a business asset is damaged but not completely destroyed, the amount of the loss is the amount of the insurance proceeds ($1,950) minus the lesser of (1) the asset's adjusted basis of $15,200 ($29,000 − $13,800) or (2) the decline in the value of the asset due to the casualty (repairs) of $3,500.

118) $27,500 = $112,000 − $84,500.

A sole proprietorship must report on the same year-end as the proprietor—in this case a calendar year.

119) $28,000 = $112,200 − $84,200.

A sole proprietorship must report on the same year-end as the proprietor—in this case a calendar year.

120) $4,000.

Prepayments are recognized as income in the year of receipt for cash-method taxpayers.

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121) Mike can elect to recognize $5,000 this year using the deferral method, but he would need to recognize $10,000 next year (and zero the following year).

The deferral method can be elected by accrual-method taxpayers in the first year a prepayment is received if the method is also used for financial accounting purposes. The deferral for services can last no longer than the tax year following the receipt of the payment.

122) Mike can elect to recognize $3,120 this year using the deferral method, but he would need to recognize $12,480 next year (and zero the following year).

The deferral method can be elected by accrual-method taxpayers in the first year a prepayment is received if the method is also used for financial accounting purposes. The deferral for services can last no longer than the tax year following the receipt of the payment.

123) $1,440 = $840 interest ($120 × 7 months—June through December of this year) plus $600 insurance ($2,700/18 × 4 months—September through December of this year).

Interest accrues ratably for an accrual-method taxpayer. Insurance is a payment liability and payment satisfies economic performance. However, since the insurance covers more than 12 months the 12-month rule does not apply and the prepayment must be prorated over the period that the expenditure benefits.

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124) $1,561 = $917 interest ($131 × 7 months—June through December of this year) plus $644 insurance ($3,220/20 × 4 months—September through December of this year).

Interest accrues ratably for an accrual-method taxpayer. Insurance is a payment liability and payment satisfies economic performance. However, since the insurance covers more than 12 months the 12-month rule does not apply and the prepayment must be prorated over the period that the expenditure benefits.

125) $2,500 is deductible last year and $3,500 is deductible this year.

Because Tim and Bob are "related" parties and Bob uses the accrual method, Bob will not deduct the fee until Tim includes it in his income.

126) Zero. The warranty cost is only deductible when paid, this year.

Warranties provided to the taxpayer are payment liabilities. Consequently, Colby is not allowed to deduct the $15,000 cost of the warranty last year. He will deduct it this year when the warranty is paid for.

127) $400,000

The accrued $1 million warranty expense is an estimate and warranty expense is a service that can be deducted only when provided or the cost is incurred. Hence, Ranger is allowed to deduct the $400,000 spent repairing equipment under the warranty.

128) Zero

Because tort liabilities such as this are payment liabilities, Blackwell will not be able to deduct any claim until it is paid.

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129) $5,000.

The all-events test is satisfied for $50,000, but Joe can only deduct $5,000 this year because that was the amount of services provided to Joe this year (unless Joe paid more and reasonably expected economic performance within three and a half months of the date of payment).

130) $3,050.

Shadow can deduct amounts paid for services provided to it this year and any amounts paid if performance is reasonably expected within three and a half months of the date of the payment.

131) $15,000.

Unless the services are rendered, Murphy can only deduct costs actually incurred, $15,000. The remainder is not deductible until next year because of economic performance.

132) $42,000 = $24,000 + $18,000.

Economic performance occurs for the rent ratably over time, so only $24,000 is accrued ($2,000 per month times six months). Insurance is a payment liability and accrues only as paid. However, since the payment spans two periods (six months this year and six months next year), the portion benefiting the future period would typically be capitalized. In this case, the duration of the contract does not exceed 12 months and the payment does not extend beyond the end of next year. So, the 12-month rule allows for the deduction of $18,000. Note that the 12-month rule cannot apply to the rent until economic performance occurs, and this only happens ratably.

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