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Correct answers located at the end of the chapter.

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 if 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 business expenses, but fines imposed by a governmental unit are deductible as long as the fines are incurred in the ordinary course of business.
   - ◎ true
   - ◎ false

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7) Although expenses associated with illegal activities are not deductible, political contributions can be deducted if 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 if the uniforms are not suitable for normal wear.
   - ◎ 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 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 $31 million or less for the prior three taxable years.
   - ◎ true
   - ◎ false

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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 the 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) Adjusted taxable income is computed after the deduction for qualified business income defined under Section 199A but without regard to any NO deduction.

◎ 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.

◎ true
◎ false

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

◎ true
◎ false

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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

25) Accrual-method taxpayers must include prepayments for goods or services into realized income.
- ◎ true
- ◎ false

26) Uniform capitalization of indirect inventory costs is required for most very large taxpayers.
- ◎ true
- ◎ false

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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

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 the choices are correct.

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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 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?

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 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

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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.

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 tickets to the super bowl with a film producer where no business was discussed.
$500 lunch with sister Nicky.
$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 the choices are deductible by Dick.

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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.

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 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 at a restaurant, and after agreeing to a business deal, they went to the theater. Holly paid $290 for the meal and separately 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) $290
C) $145
D) $125
E) None—the meals and entertainment are not deductible except during travel.

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41) Holly took a prospective client to dinner at a restaurant, and after agreeing to a business deal, they went to the theater. Holly paid $290 for the meal and separately 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) $290
C) $145
D) $125
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 purchased at the conference	220
Meal with an old friend	120
Lodging in New Jersey	450
Rental car	180

A) $2,850
B) $2,740
C) $1,850, if Shelley itemizes the deductions
D) All 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.

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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	$ 2,160
Meals purchased at the conference	236
Meal with an old friend	130
Lodging in New Jersey	434
Rental car	196

A) $3,026
B) $2,908
C) $1,946, if Shelley itemizes the deductions
D) All 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) Lodging and incidental expenditures are fully deductible if the taxpayer is away from home overnight while traveling on business.
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 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.

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) The deduction 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.

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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. Which of 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) $250 spent on lodging while traveling away from home on business.
C) $2,000 spent by the employer on reimbursing an employee for entertainment.
D) All these expenses are fully deductible.
E) None of these expenses can be deducted in full.

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. Primary purpose is business.

$500 in meals at restaurants 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.

A) $1,250 "for AGI"
B) $1,250 "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.

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50) Ed is a self-employed heart surgeon who lives in Michigan and has incurred the following reasonable expenses. How much can Ed deduct?
$1,440 in airfare to repair investment rental property in Colorado. Primary purpose is business.
$660 in meals at restaurants while attending a medical convention in New York.
$380 for tuition for an investment seminar, "How to pick stocks."
$102 for tickets to a football game with hospital administrators to celebrate successful negotiation of a surgical contract earlier in the day.

A) $1,770 "for AGI"
B) $1,820 "for AGI" and $330 "from AGI"
C) $510 "for AGI"
D) $82 "for AGI" and $1,820 "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?

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 business interest limitation that George will be subject to this year if the business does not qualify under the gross income test and reports no interest income?

A) $477,000
B) $522,000
C) $375,000
D) $300,000
E) $228,000

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53) George operates a business that generated revenues of $55 million and allocable taxable income of $1.30 million. Included in the computation of allocable taxable income were deductible expenses of $242,500 of business interest and $252,500 of depreciation. What is the business interest limitation that George will be subject to this year if the business does not qualify under the gross income test and reports no interest income?

A) $482,000
B) $538,500
C) $378,750
D) $314,250
E) $230,375

54) George operates a business that 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 if the business does not qualify under the gross income test?

A) $168,000
B) $452,000
C) $612,000
D) $506,000
E) $486,000

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

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 gross receipts.
C) This limitation is not imposed on businesses with average annual gross receipts of $31 million or less for the prior three taxable years.
D) All the choices are false.
E) All the choices are true.

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56) 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; interest expense, net operating loss carryovers; depreciation, amortization, and depletion deductions; and the qualified business income (QBI) deduction under Section 199A.
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.

57) The business interest limitation is based on which of the following:
A) business interest income plus 30 percent of adjusted taxable income.
B) 30 percent of business revenue after deducting depreciation and interest expense.
C) debt invested in the business.
D) interest income after adding back 30 percent of all deductible expenses.
E) None of the choices are correct.

58) 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?
A) $6,000
B) $14,000
C) $5,800
D) $4,600
E) $5,300

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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 $21,000, and the adjusted basis was $5,675 at the time of the accident. Although the van was worth $6,100 at the time of accident, insurance only paid Riley $1,325 for the loss. What is the amount of Riley's casualty loss deduction?

A) $6,100
B) $14,900
C) $5,675
D) $4,350
E) $5,225

60) 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

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 $30,500, and the adjusted basis was $1,950 at the time of the accident. The taxi was repaired at a cost of $2,525 and insurance reimbursed Don $703 of this cost. What is the amount of Don's casualty loss deduction?

A) $1,247
B) $2,525
C) $1,822
D) $1,950
E) Don is not eligible for a casualty loss deduction

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

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

63) 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 promise from 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

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

- $210 in cash from a customer for services rendered this year
- a promise from a customer to pay $178 for services rendered this year
- tickets to a football game worth $195 as payment for services performed last year
- a check for $192 for services rendered this year that Bill forgot to cash

How much income should Bill realize on Schedule C?

A) $210
B) $388
C) $405
D) $402
E) $597

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65) 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) $1,080

66) 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?

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

67) 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.

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68) 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.

69) 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 1st of year 1 through May 31st of year 3. When must Colbert recognize the income if his accounting methods are selected to minimize income recognition?
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.

70) Which of the following types of transactions does not result in the immediate recognition of revenue or expense for a small business using the cash method?
A) Sales of inventory on account
B) A note received from a customer in exchange for services rendered
C) Salaries paid to employees by check
D) Credit card payments from customers for services received
E) All the choices will result in recognition of revenue or expense using the cash method.

71) Which of the following types of expenditures is not subject to capitalization under the uniform cost capitalization (UNICAP) rules?
A) Selling expenditures
B) Cost of manufacturing labor
C) Compensation of managers who supervise production
D) Cost of raw materials
E) All the choices are subject to capitalization under the UNICAP rules

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72) 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?

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

73) Mike started a calendar-year business on September 1st of this year by paying 12 months of 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

74) Mike started a calendar-year business on September 1stSeptember 1st of this year by paying 12 months of rent on his shop at $1,450 per month. What is the maximum amount of rent that Mike can deduct this year under each type of accounting method?

A) $17,400 under the cash method and $17,400 under the accrual method
B) $5,800 under the cash method and $17,400 under the accrual method
C) $17,400 under the cash method and $5,800 under the accrual method
D) $5,800 under the cash method and $5,800 under the accrual method
E) $5,800 under the cash method and zero under the accrual method

75) Which of the following is a payment liability?

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

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76) 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 the choices are true.

77) 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.

78) 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 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 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

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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 $1.70 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 $1,200,000 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) $1.70 million
B) $1,200,000
C) $2.90 million
D) $2.90 million only if the professional golf tournament is played before April 15
E) No deduction can be claimed this year

80) 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?

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.

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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 $13,500 in rebates and was liable for an additional $8,250 in rebates to buyers. What amount of the rebates, if any, can Big Homes deduct this year?

A) $13,500 because rebates are payment liabilities.
B) $21,750 because Big Homes is an accrual-method taxpayer.
C) $21,750 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) $13,500 because the $8,250 liability is not fixed and determinable.
E) Big Homes is not entitled to a deduction because rebates are against public policy.

82) 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.

83) Jones operates an upscale restaurant, and he pays experienced cooks $40,000 per year. This year, he hired his son as an apprentice cook. Jones agreed to pay his son $44,000 per year. Which of the following is a true statement about this transaction?

A) Jones will be allowed to deduct $44,000 only if his son eventually develops into an expert cook.
B) Jones will be allowed to accrue $44,000 only if he pays his son in cash.
C) Jones will be allowed to deduct $40,000 as compensation and another $4,000 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) 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

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 $14,400. At the end of the year, Manley recorded bad debt expense of $21,700 and the balance of doubtful accounts had increased to $19,300. What is Manley's deduction for bad debt expense this year?

A) $21,700
B) $4,900
C) $26,600
D) $2,400
E) $16,800

86) 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 these are related parties.

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87) 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.

88) Which of the following is a true statement about impermissible accounting methods?
A) An impermissible method is adopted by using the method to report results for two consecutive years.
B) An impermissible method may not be adopted 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.

89) 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.

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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 $420,500 of sales on account, and $64,200 was uncollected at the end of the year. What is Todd's §481 adjustment for this year?

A) Increase income by $420,500
B) Increase income by $16,050
C) Increase expenses by $64,200
D) Increase expenses by $420,500
E) Todd has no &sect481 adjustment this year.

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

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 the choices are true.

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

92) 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.

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93) Smith operates a roof repair business. This year, Smith's business generated cash receipts of $33,230, and Smith made the following expenditures associated with his business:

Advertising	$ 565
Car and truck expenses	1,308
Depreciation	3,234
Employee compensation	5,325
Education	2,300

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) 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.

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 $17,150, but Bryon paid Fred $27,600 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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96) 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 at a restaurant and then spent $600 for tickets to the game. What is the deductible amount of these expenses?

97) 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.

98) Crystal operates a business that provides typing and delivery services. This year, Crystal spent $2,580 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 $5,400 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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99) 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 result, 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.

100) Judy is a self-employed musician who performs for a variety of events. This year, Judy was fined $340 by the city for violating the city's noise ordinance with a relatively loud performance. As a result, Judy contributed $820 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 $34,800 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 $53,200 rather than $34,800. 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) 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 at restaurants, and $80 a day for a rental car. What amount of these travel expenditures may Danny deduct as business expenses?

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102) Danny owns an electronics outlet in Dallas. This year, he paid $630 to register for a four-day course in management in Chicago. Danny paid $770 in airfare and $880 for five nights' lodging. After the course, Danny spent the last day sightseeing. During the trip, Danny also paid $200 a day for meals at restaurants, and $140 a day for a rental car. What amount of these travel expenditures may Danny deduct as business expenses?

103) 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 at restaurants (10 days)	1,500

What amount of travel expenditures can Sam deduct?

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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	$ 2,800
Airfare	890
Hotel (10 nights)	2,100
Rental car (10 days)	810
Meals at restaurants (10 days)	2,400

What amount of travel expenditures can Sam deduct?

105) 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 (10,700 miles this year), and her $8,350 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.

106) 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?

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107) Sandy Bottoms Corporation generated $50 million of revenue this year and reported taxable income of $1.3 million. Taxable income included $350,000 of interest income and deductions for interest expense of $1.5 million and $800,000 of depletion deductions. What is Sandy Bottoms' maximum interest expense deduction for the year if the business does not qualify under the gross income test?

108) Sandy Bottoms Corporation generated $50 million of revenue this year and reported taxable income of $1.7 million. Taxable income included $390,000 of interest income and deductions for interest expense of $1.70 million and $900,000 of depletion deductions. What is Sandy Bottoms' maximum interest expense deduction for the year if the business does not qualify under the gross income test?

109) Sandy Bottoms Corporation generated taxable income of $600,000. Taxable income included $70 million of revenue and $50,000 of interest income. Deductions included $400,000 of interest expense, $130,000 of depreciation, and a $60,000 deduction for an NOL carryover from a prior year. What is Sandy Bottoms' maximum interest expense deduction for the year if the business does not qualify under the gross income test?

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110) Rock Island Corporation generated taxable income (before deductions for depreciation, interest expense, and net operating loss carryovers) of $600,000 this year. Taxable income was computed on $50 million of revenues and included $40,000 of interest income. The company paid $450,000 in interest expense and claimed deductions for $150,000 of depreciation. What is Rock Island's maximum business interest deduction for the year if the business does not qualify under the gross income test?

111) Rock Island Corporation generated taxable income (before deductions for depreciation, interest expense, and net operating loss carryovers) of $650,000 this year. Taxable income was computed on $50 million of revenues and included $90,000 of interest income. The company paid $452,500 in interest expense and claimed deductions for $300,000 of depreciation. What is Rock Island's maximum business interest deduction for the year if the business does not qualify under the gross income test?

112) Rock Island Corporation generated taxable income of $100,000. Taxable income was computed on $50 million of revenues that included $45,000 of interest income and deductions for $40,000 in interest expense and $8,000 for a net operating loss carryover. What is Rock Island's maximum business interest deduction for the year if the business does not qualify under the gross income test?

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113) 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?

114) 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 $23,500 and claimed depreciation of $12,700 up to the fire. Otto was charged $4,050 for repairs to the oven but the insurance company paid Otto $1,675 for the damage. What is Otto's casualty loss deduction?

115) 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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116) David purchased a deli shop on February 1stFebruary 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 31stJanuary 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?

117) 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?

118) 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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119) Mike operates a fishing outfitter as an accrual-method sole proprietorship. On March 1stMarch 1st of this year, Mike received $17,100 for four 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 four summers, beginning this year. How much income must Mike recognize in each of the next four years if he is attempting to minimize his tax burden?

120) 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?

121) Anne is a self-employed electrician who reports her business income using the accrual method over a calendar year. On September 1stSeptember 1st of this year, Anne paid $2,337 of interest on a loan. The interest accrues evenly over 19 months ($123 per month) from June 1stJune 1st of this year through December 31stDecember 31st of next year. In addition, on September 1stSeptember 1st Anne also paid $2,754 for 18 months of professional liability insurance ($153 per month). What amount of interest and insurance can Anne deduct this year?

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122) 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-method 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?

123) 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?

124) 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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125) 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?

126) 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?

127) 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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128) 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?

129) 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: Chapter 01

1) TRUE
2) TRUE
3) FALSE
4) FALSE
5) TRUE
6) FALSE
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
21) TRUE
22) TRUE
23) TRUE
24) TRUE
25) FALSE
26) TRUE
27) C
28) B
29) C
30) D
31) D
32) D
33) E
34) A
35) E
36) D
37) C

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38) B
39) A
40) C
41) C
42) A
43) B
44) B
45) A
46) D
47) D
48) B
49) A
50) A
51) D
52) B
53) B
54) D
55) C
56) A
57) A
58) D
59) D
60) A
61) A
62) D
63) E
64) E
65) A
66) B
67) D
68) D
69) B
70) A
71) A
72) C
73) C
74) C
75) E
76) E
77) B

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78) A
79) A
80) C
81) C
82) E
83) E
84) E
85) E
86) D
87) B
88) A
89) B
90) B
91) E
92) Essay
93) Essay
94) Essay
95) Essay
96) Essay
97) Essay
98) Essay
99) Essay
100) Essay
101) Essay
102) Essay
103) Essay
104) Essay
105) Essay
106) Essay
107) Essay
108) Essay
109) Essay
110) Essay
111) Essay
112) Essay
113) Essay
114) Essay
115) Essay
116) Essay
117) Essay

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118) Essay
119) Essay
120) Essay
121) Essay
122) Essay
123) Essay
124) Essay
125) Essay
126) Essay
127) Essay
128) Essay
129) Essay

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