# *Concepts in Federal Taxation 2017 24th edition Murphy Test Bank*

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Chapter 2

1. Under the pay-as-you-go concept, the tax base used to compute the taxpayer's income tax liability is a net income number.

a. True

b. False

*ANSWER:* False

2. The administrative convenience concept explains why some items are not treated consistently when the cost of implementing a concept exceeds the benefit of using it.

a. True

b. False

*ANSWER:* True

3. John sells his uncle Bob land held for investment for $10,000 that he had purchased 3 years ago for $12,000. John is precluded from taking the $2,000 loss under the arm's-length transaction concept since this is a related party transaction.

a. True

b. False

*ANSWER:* False

4. Under the ability-to-pay concept, taxpayers are required to have tax withheld from income or to make estimated tax payments so that the taxpayer avoids a large tax liability at the end of the year.

a. True

b. False

*ANSWER:* False

5. An individual can legally assign income to another individual, and the assignment relieves the owner of the income from paying tax on the income.

a. True

b. False

*ANSWER:* False

6. Benji hired his three-year-old son to work in his engineering consulting firm. As long as Benji fills out all the forms and properly deposits the paychecks in his son's bank account, he will be able to deduct the expenditure as a business expense.

a. True

b. False

*ANSWER:* False

7. Any deduction taken in a prior year that is recovered in a subsequent year is reported as income in the year it is recovered, to the extent that a tax benefit was received from the deduction.

a. True

b. False

*ANSWER:* True

8. Under the all-inclusive income concept, the tax law always starts with the proposition that all receipts of cash are taxable.

a. True

b. False

*ANSWER:* True

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9. Frank rents an apartment to Pete and collects a cleaning deposit to be repaid at the end of the lease. Under the claim-of-right doctrine, Frank includes the deposit in income when collected.

a. True

b. False

*ANSWER:* False

10. The Nadal Company mails its annual dividend check on December 31. Even when the shareholders receive their check in the following year, they must report the income in the year the check was written and mailed.

a. True

b. False

*ANSWER:* False

11. Under the Wherewithal to Pay concept, income should be recognized and a tax paid on the income when the taxpayer has the resources to pay the tax.

a. True

b. False

*ANSWER:* True

12. Bethany bought a new suit to wear to work. She will not be able to deduct the cost of the suit even though she wears it to work.

a. True

b. False

*ANSWER:* True

13. An asset's adjusted basis is the amount of unrecovered investment after considering any increases and decreases in the original purchase price.

a. True

b. False

*ANSWER:* True

14. The taxpayer will be able to benefit from capital recovery on business equipment over the life of the asset and any remaining capital will be recovered when the asset is sold.

a. True

b. False

*ANSWER:* True

15. All deductions are allowed because of the legislative grace concept.

a. True

b. False

*ANSWER:* True

16. When items of income are omitted because the cost of the time and effort of the taxpayer to accumulate the information, it is an application of the

a. Ability to Pay Concept.

b. Administrative Convenience Concept.

c. Arm's-Length Transaction Concept.

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d. Capital Recovery Concept.
e. Pay-as-You-Go Concept.

*ANSWER:* b

17. Sam coaches a little league baseball team. He makes 15 copies of the team's schedule to give to the players on his employer's copy machine. The cost of the copies is not income to Sam due to the
a. Ability to Pay Concept.
b. Administrative Convenience Concept.
c. Arm's-Length Transaction Concept.
d. Capital Recovery Concept.
e. Pay-as-You-Go Concept.

*ANSWER:* b

18. The rules that limit self-dealing through the related party provisions is a result of the
a. Ability to Pay Concept.
b. Administrative Convenience Concept.
c. Arm's-Length Transaction Concept.
d. Capital Recovery Concept.
e. Pay-as-You-Go Concept.

*ANSWER:* c

19. Susan purchased a lot for investment purposes. She paid $10,000 for the lot. Three years later she sold the lot to her daughter for $8,000. Susan cannot deduct the loss due to
a. Ability to Pay Concept.
b. Administrative Convenience Concept.
c. Arm's-Length Transaction Concept.
d. Capital Recovery Concept.
e. Pay-as-You-Go Concept.

*ANSWER:* c

20. Withholding of taxes from the taxpayers wages and quarterly estimated tax payments are a result of the
a. Ability to Pay Concept.
b. Administrative Convenience Concept.
c. Arm's-Length Transaction Concept.
d. Capital Recovery Concept.
e. Pay-as-You-Go Concept.

*ANSWER:* e

21. Thomas had $8,500 withheld from his paycheck, but since he has a large amount of interest and dividends, he is required to make quarterly estimated tax payments due to the
a. Ability to Pay Concept.
b. Administrative Convenience Concept.
c. Arm's-Length Transaction Concept.
d. Capital Recovery Concept.
e. Pay-as-You-Go Concept.

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*ANSWER:* e

22. Jerome, a self-employed attorney, is scrambling around to refigure his estimated 2016 income tax liability, because he needs to mail his third quarter estimated tax payment tomorrow (September 15, 2016). What concept, construct, or doctrine is causing Jerome to scramble?

a. Administrative Convenience Concept.
b. Ability To Pay Concept.
c. Arms-length Transaction Concept.
d. Pay- As-You-Go Concept.
e. Assignment of Income Doctrine.

*ANSWER:* d

23. The IRS has a penalty for underpayment of estimated taxes. This penalty exists because of which of the following concepts, constructs, or doctrines?

a. Pay-As-You-Go.
b. Tax Benefit Rule.
c. Substance-Over-Form.
d. Administrative Convenience.
e. Ability-To-Pay.

*ANSWER:* a

24. The allowance of deductions in calculating taxable income and the use of a progressive tax rate structure are a direct application of the

a. Ability to Pay Concept.
b. Administrative Convenience Concept.
c. Arm's-Length Transaction Concept.
d. Capital Recovery Concept.
e. Pay-as-You-Go Concept.

*ANSWER:* a

25. Victor receives a $2,000 tax credit for childcare. The credit was earned because of Victor's expenditures for daycare for his son while Victor worked. What concept, construct, or doctrine helps explain why Victor receives this tax credit?

a. Ability to Pay Concept.
b. Administrative Convenience Concept.
c. Arm's-Length Transaction Concept.
d. Capital Recovery Concept.
e. Pay-as-You-Go Concept.

*ANSWER:* a

26. No income is taxed until the taxpayer is allowed the return of the original investment due to the

a. Ability to Pay Concept.
b. Administrative Convenience Concept.
c. Arm's-Length Transaction Concept.
d. Capital Recovery Concept.
e. Business Purpose concept

*ANSWER:* d

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27. Carter sold 100 shares of Mitsui, Inc. for $8,000 but he only recognized $2,000 as income because the original purchase price was $6,000. This is due to the

a. Ability to Pay Concept.
b. Administrative Convenience Concept.
c. Arm's-Length Transaction Concept.
d. Capital Recovery Concept.
e. Business Purpose Concept.

*ANSWER:* d

28. The ability-to-pay concept is fundamental to the income tax structure. Constructs used to implement this concept include

I. Deductions
II. Progressive tax rates
III. Exclusions
IV. Business losses

a. Only statement II is correct.
b. Statements I, III, and IV are correct.
c. Statements I, II, and IV are correct.
d. Statements I and III are correct.
e. Statements I, II, III, and IV are correct.

*ANSWER:* c

29. Which of the following is/are based on an ability-to-pay concept?

I. A flat tax .
II. Johson City charges all households a flat fee of $25 per month for water usage.
III. Boone County recently established Route 89 as a toll road. All cars traveling from East Johnson City to Appleton pay $1.

a. Only statement I is correct.
b. Only statement II is correct.
c. Statements II and III are correct
d. Statements I, II, and III are correct.
e. None of the statements are correct.

*ANSWER:* e

30. Some discontented taxpayers have suggested that complexity be removed from the income tax structure by applying a flat tax rate to the gross income of all taxpayers. This approach violates which concept?

a. Ability to Pay Concept.
b. All-inclusive Income Concept.
c. Entity Concept.
d. Pay-as-You-Go Concept.
e. Wherewithal to Pay Concept.

*ANSWER:* a

31. Allowing individuals to deduct a standard deduction amount in lieu of itemizing their allowable personal deductions is an application of the

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a. Administrative Convenience Concept.
b. Wherewithal-to-Pay Concept.
c. Annual Accounting Period Concept
d. Capital Recovery Concept.
e. Business Purpose Concept.

*ANSWER:* a

32. Sanchez Company allows its employees to make personal copies without charge on the company copy machines. What concept, construct, or doctrine helps explain why the benefit received is not taxable to Sanchez employees?

a. Administrative Convenience Concept.
b. Assignment of Income Doctrine.
c. Arms-length Transaction Concept.
d. Ability To Pay Concept.
e. Pay As You Go Concept.

*ANSWER:* a

33. Which of the following concepts/doctrines state(s) that items may be omitted from the tax base whenever the cost of implementing a concept exceeds the benefit of using it?

a. Ability-to-Pay.
b. Administrative Convenience.
c. Arm's-length Transaction.
d. Substance-Over-Form.
e. Tax Benefit Rule.

*ANSWER:* b

34. Sandra sells a business-use warehouse to her wholly owned corporation. Sandra realizes a loss of $13,000 on the sale. (Sales price, $102,000, less adjusted basis, $115,000). Tax law does not permit Sandra a deduction for the $13,000 loss. Which of the following explain(s) this tax result?

I. Arm's-length Transaction Concept.
II. Pay-As-You-Go Concept.
III. Legislative Grace Concept
IV. Business Purpose Concept.

a. Only statement I is correct.
b. Only statement II is correct.
c. Statements III and IV are correct.
d. Statements I and III are correct.
e. Statements I, II, III, and IV are correct.

*ANSWER:* a

35. Which of the following is a taxable entity?

a. Sole Proprietorship.
b. Partnership.
c. S Corporation.
d. C Corporation.

*ANSWER:* d

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36. According to the entity concept
I. each unit must keep separate records.
II. each unit reports the results of operations separate and apart from owners.
III. every unit is liable for tax on its income.
IV. each unit is classified as one of two basic entity types.

a. Statements I and II are correct.
b. Statements II and III are correct.
c. Only statement IV is correct.
d. Statements I, III, and IV are correct.
e. Statements I, II, and IV are correct.

*ANSWER:* e

37. According to the entity concept
I. a sole proprietorship is similar to a conduit entity.
II. a sole proprietor cannot convert nondeductible personal items into deductible business items by commingling expenditures.
III. a partnership is an example of a mixture of a taxable and a conduit entity.
IV. an S corporation is a tax paying entity.

a. Statements I and II are correct.
b. Statements II and III are correct.
c. Only statement IV is correct.
d. Statements I, II, and III are correct.
e. Statements I, II, and IV are correct.

*ANSWER:* a

38. During the current year, Trane invests $35,000 in each of two separate corporations. Each investment gives him a 20% ownership interest. Brazil Corporation is a regular corporation that has taxable income of $200,000 and pays dividends totaling $50,000. China Corporation is an S corporation that has taxable income of $100,000 and pays $50,000 of dividends. As a result of these two investments, Trane
I. Has $40,000 of taxable income from Brazil Corporation.
II. Has $20,000 of taxable income from China Corporation.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* b

39. During the current year, Walter invests $35,000 in each of two separate corporations. Each investment gives him a 20% ownership interest. Corporation X is a C corporation that has taxable income of $200,000 and pays dividends totaling $50,000. Corporation Z is an S corporation that has taxable income of $100,000 and pays $50,000 of dividends. As a result of these two investments, Walter
I. Has $10,000 of taxable income from Corporation X.
II. Has $10,000 of taxable income from Corporation Z.

a. Only statement I is correct.
b. Only statement II is correct.

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c. Both statements are correct.

d. Neither statement is correct.

*ANSWER:* a

40. In the current year, Darlene purchases a 20% interest in the Grant Partnership (GP) for $10,000. During the current year, GP has a taxable income of $80,000 and Darlene withdraws $5,000 of cash from the partnership. Darlene's income to be reported from her investment in GP and her basis in GP at the end of the year is:

| Income | Basis |
|---|---|
| a. $16,000 | $21,000 |
| b. $5,000 | $26,000 |
| c. $16,000 | $10,000 |
| d. $5,000 | $10,000 |

*ANSWER:* a

41. Will is a partner in Oil Exploration Limited Partnership. For the current year, the partnership reports net income of $130,000. Will's share of the income is $1,300. Will reports that amount in his gross income. The partnership pays no income tax on its earnings. What concept, construct, or doctrine applies here?

a. Annual Accounting Period Concept.

b. Arms-length Transaction Concept.

c. Assignment of Income Doctrine.

d. Entity Concept.

e. Substance Over Form Doctrine.

*ANSWER:* d

42. Alfred is a consultant for Data Planners. In an effort to minimize his tax liability he enters into a legal contract transferring 25% of the fees from a new consulting contract to his son Ken, who is 42, and owns a pest control business. Which of the following statements concerning the transaction is correct?

I. The assignment-of-income doctrine prevents Alfred from transferring taxation of the income to his son.

II. The assignment-of- income doctrine does not apply because the transfer is supported by a legal contract.

a. Only statement I is correct.

b. Only statement II is correct.

c. Both statements are correct

d. Neither statement is correct.

*ANSWER:* a

43. Ronald is a consultant for Economic Forecasters, Inc. In an effort to minimize his tax liability he enters into a legal contract transferring 25% of the fees from a new consulting contract to his son Ken, who is 42, and owns a pest control business. Which of the following statements concerning the transaction is correct?

I. The assignment-of-income doctrine does not apply if Ken and Ronald are in the same marginal tax bracket.

II. The assignment-of- income doctrine does not apply if Ronald's son is under age 14.

a. Only statement I is correct.

b. Only statement II is correct.

c. Both statements are correct.

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d. Neither statement is correct.

*ANSWER:* d

44. Rachel paid $1,000 for supplies in 2015. In 2016, the vendor finds a $200 mistake on the invoice and refunds the overpayment to Rachel. Which of the following doctrines or concepts is the ***least*** helpful in determining how the 2016 transaction should be reported for tax purposes?

a. Accounting Period.

b. Tax Benefit Rule.

c. Claim of Right.

d. Assignment of Income.

e. All-Inclusive Income.

*ANSWER:* d

45. Isabel is a self-employed electrician. All cash payments she receives from customers are deposited into a bank account held in the name of her son. Isabel does not have use of the funds. Therefore, she does not think she needs to include the cash receipts in her gross income. What concept or doctrine applies to this situation?

a. Pay As You Go Concept.

b. Assignment of Income Doctrine.

c. Annual Accounting Period Concept.

d. Substance Over Form Doctrine

e. Arms-length Transaction Concept.

*ANSWER:* b

46. Samuel owns some land, which has an oil deposit underneath it. His annual royalties vary from $50,000 to $60,000. Because Samuel is in the highest marginal tax rate bracket, he would like to have some (or all) of the royalty income taxed to his son, Jack, thus lowering the overall tax on the royalty income. To do this

I. Samuel can gift part of the land to Jack.
II. Samuel can gift part of each year's royalties to Jack.

a. Only statement I is correct.

b. Only statement II is correct.

c. Both statements are correct.

d. Neither statement is correct.

*ANSWER:* a

47. Riley owns some land, which has an oil deposit underneath it. His annual royalties are usually around $100,000. Because Riley is in the highest marginal tax rate bracket, he would like to have some (or all) of the royalty income taxed to his son, Mark, thus lowering the overall tax on the royalty income. To do this

I. Riley can gift part of the land to Mark.
II. Riley can gift all of the land to Mark.

a. Only statement I is correct.

b. Only statement II is correct.

c. Both statements are correct.

d. Neither statement is correct.

*ANSWER:* c

48. On June 1, Don receives a rental house from his Uncle Sidney as a graduation present. The monthly rental on the

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house is $1,000. On June 25, the tenant pays Uncle Sidney the $1,000 rent payment for June by mistake. Which of the following concepts, constructs, or doctrines is the ***most*** relevant in determining the tax treatment of the $1,000 rental payment?

a. Capital Recovery Concept.
b. Assignment of Income Doctrine.
c. Constructive Receipt Doctrine.
d. Wherewithal-to-Pay Concept.
e. Substance Over Form Doctrine.

*ANSWER:* b

49. Marianne's uncle Mike gives her $20,000 of 8% bonds on July 1st of the current year. The bonds pay interest on June 30 and December 31.

I. Marianne has $20,000 of income from the receipt of the bonds.
II. Marianne has $1,600 of interest income from the bonds in the year of the gift.
III. Marianne has $800 of interest income from the bonds in the year of the gift.
IV. Mike has $800 of interest income from the bonds in the year of the gift.

a. Only statement I is correct.
b. Only statement II is correct.
c. Statements I and III are correct.
d. Statements I and II are correct.
e. Statements III and IV are correct.

*ANSWER:* e

50. Rodrigo has $5,000 of state income taxes withheld from his salary during 2015. On his 2015 income tax return, Rodrigo properly deducts the $5,000 as state taxes paid. Upon filing his 2015 state tax return on April 15, 2016, he determines that his actual State income tax for 2015 is only $4,100. He receives a $900 refund on May 25, 2016 from the amounts withheld by the state. What concept(s), construct(s), or doctrine(s) dictate that the $900 is included in Rodrigo's 2016 income?

I. Annual Accounting Period Concept.
II. Tax Benefit Rule.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* c

51. Wintrop has $4,000 of state income taxes withheld from his salary during 2015. On his 2015 income tax return, Wintrop properly deducts the $4,000 as state taxes paid. Upon filing his 2015 state tax return on April 15, 2016, he determines that his actual State income tax for 2015 is only $3,300. He receives a $700 refund on May 25, 2016 from the amounts withheld by the state. What concept(s), construct(s), or doctrine(s) dictate that the $700 is included in Wintrop's 2016 income?

I. Claim of Right Doctrine.
II. Constructive Receipt Doctrine.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.

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d. Neither statement is correct.

*ANSWER:* d

52. Joanne, a single individual, has $2,000 in state taxes withheld from her salary in 2016. Her total itemized deductions are $6,350. She claims the $2,000 as an itemized deduction on her 2016 tax return. In 2017 she receives a state income tax refund of $700. Under the tax benefit rule she has to report income in 2017 of

a. $2,000

b. $ 700.

c. $ 50.

d. $ -0-.

e. $ -0-, but Joanne must file an amended 2016 tax and reduce her itemized deductions by $700.

*ANSWER:* c

53. Margarita, a single individual, has $2,000 in state taxes withheld from her salary in 2015. Her total itemized deductions are $7,500. She claims the $2,000 as an itemized deduction on her 2015 tax return. In 2016, she receives a state income tax refund of $400. Under the tax benefit rule she has to report income in 2016 of

a. $2,000.

b. $ 400.

c. $ 200.

d. $ -0-.

e. $ -0-, but Margarita must file an amended 2015 tax and reduce her itemized deductions by $400.

*ANSWER:* b

54. Which of the following constructs have developed from the Annual Accounting Period Concept?

I. Entity Concept.
II. Capital Recovery.
III. Related Party.
IV. Tax Benefit Rule.

a. Only statement I is correct.

b. Statements II and III are correct.

c. Statements III and IV are correct.

d. Only statement IV is correct.

e. Statements II, III, and IV are correct.

*ANSWER:* d

55. A crucial question concerning income is when to recognize it (in which accounting period income should income be taxed?). Which of the following help resolve the problems of timing?

I. Realization Concept.
II. Accounting Method.
III. Constructive Receipt.
IV. Substance-Over-Form Doctrine.

a. Statements I and II are correct.

b. Only statement I is correct.

c. Only statement II is correct.

d. Statements I, II, and III are correct.

e. Statements I, II, III, and IV are correct.

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*ANSWER:* d

56. Fay "hires" her four-year-old son to be the office manager of her real estate firm. She deducts his $20,000 annual salary as a business expense. The IRS disallows the deduction upon examination of Fay's tax return. Which of the following supports the IRS position?

a. All-Inclusive Income Concept.
b. Annual Accounting Period Concept.
c. Entity Concept.
d. Realization Concept.
e. Business Purpose Concept

*ANSWER:* e

57. The broadest income concept

I. considers all income received (e.g., cash, property, services, etc.) taxable.
II. implies that anything of value received may be taxable.
III. is referred to as the legislative grace concept.
IV. implies that all increases in wealth may be taxable

a. Only statement II is correct.
b. Statements I, II and III are correct.
c. Statements I, II, and IV are correct.
d. Statements I and IV are correct.
e. Statements I, II, III, and IV are correct.

*ANSWER:* c

58. After buying books at the beginning of the semester, Iris finds a $50 bill outside the door of the bookstore. The $50 is considered gross income. Which of the following supports this treatment?

a. All-inclusive Income Concept.
b. Capital Recovery Concept.
c. Wherewithal-To-Pay Concept.
d. Administrative Convenience.
e. Constructive Receipt Doctrine.

*ANSWER:* a

59. After buying a new sofa at the furniture store, Hilda finds a $1,000 bill in the parking lot near her car. What are the tax effects of this find?

I. Hilda must recognize $1,000 of income for this tax year.
II. The all-inclusive-income concept applies in this situation.
III. Hilda will not recognize the $1,000 because the IRS will never know about the windfall.
IV. Hilda will not recognize the $1,000 because there is not a specific tax law provision requiring it.

a. Only statement I is correct.
b. Only statement II is correct.
c. Only statement IV is correct.
d. Statements I and II are correct.
e. Statements II and III are correct.

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*ANSWER:* d

60. Betty is a house painter and owns Trim Beautiful Painting Company. Last month she painted the lake cottage of Anne, a local attorney who performed some litigation work for Betty to help in some delinquent bill collection. The painting, valued at $1,000, was done in exchange for the litigation work. Neither party charged fees. What should be the tax consequences of these events?

I. Anne reports $1,000 of income when the painting is completed.
II. No cash was received. Therefore, neither party reports income.
III. Neither individual reports income because there is no reporting of the event to the IRS.
IV. Both parties report income because there is no exclusion for barter transactions..

a. Only statement I is correct.
b. Statements II and IV are correct.
c. Only statement II is correct.
d. Statements I and IV are correct.
e. Only statement IV is correct.

*ANSWER:* d

61. In June, Catherine receives stock worth $12,000 as a graduation present from her Grandfather. The following November she receives an $800 cash dividend on the stock. Catherine must include the $800 dividend in her gross income, but excludes the $12,000 value of the stock received. The income tax concept(s) that require this treatment include:

I. Ability-to-Pay Concept.
II. All-inclusive Income Concept.
III. Constructive Receipt Doctrine.
IV. Legislative Grace Concept.

a. Only statement III is correct.
b. Statements III and IV are correct.
c. Statements I and III are correct.
d. Statements II and IV are correct.
e. Only statement I is correct.

*ANSWER:* d

62. Capital assets include which of the following?

I. Depreciable equipment used in Robbie's business.
II. A new car held for resale by Andrews Auto Sales.
III. Accounts receivable held by Jessica because of sales on credit while operating her store.
IV. A set of golf clubs, belonging to a surgeon.

a. Only statement I is correct.
b. Only statement IV is correct.
c. Statements III and IV is correct.
d. Statements I, III, and IV are correct.
e. Statements I, II, III, and IV are correct.

*ANSWER:* b

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63. Ted sells 200 shares of common stock for $2,000. The stock cost Ted $500 several years ago. Ted's realized gain from the sale is only $1,500. Which of the following provides support for this treatment?

a. Annual Accounting Period Concept.
b. Capital Recovery Concept.
c. Wherewithal-To-Pay Concept.
d. Claim of Right Doctrine.
e. Constructive Receipt Doctrine.

*ANSWER:* b

64. In 2007, Gaylord purchased 100 shares of stock of Chisel Corporation for $200 per share. In 2016, Gaylord sells all of the shares for $19,000. What are the effects of these events?

I. The capital recovery concept prevents the recognition of any income.
II. Gaylord reports $1,000 of ordinary income for tax year 2016.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* a

65. Carlota sells her personal automobile for $1,000. The car cost her $10,000 nine years ago. What are the tax effects of the current sale?

I. Carlota realizes a transaction loss of $9,000 due to the capital recovery concept.
II. Carlota realizes income of $1,000 due to the all-inclusive-income concept.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* a

66. Roseanne sells her personal automobile for $1,000. The car cost her $12,000 nine years ago. What are the tax effects of the current sale?

I. Roseanne recognizes a deductible loss of $11,000 on her current-year tax return due to the capital recovery concept.
II. Roseanne recognizes no loss on her tax return due to lack of business purpose with the automobile.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* b

67. Duncan purchased State of Wisconsin general-purpose bonds at a cost of $3,400 in 2014. He receives $170 interest on the bonds in 2014, 2015, and 2016. In 2016, he sells the bonds for $3,800. Duncan excludes the bond interest, but must include a $400 capital gain in his 2016 gross income. Which of the following Concepts, Constructs, and/or Doctrines help in forming the basis for this treatment?

I. Capital Recovery Concept.

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II. Legislative Grace Concept.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* c

68. Tim purchased State of Idaho general-purpose bonds at a cost of $3,400 in 2014. He receives $170 interest on the bonds in 2014, 2015, and 2016. In 2016, he sells the bonds for $3,800. Tim excludes the bond interest, but must include a $400 capital gain in his 2016 gross income. Which of the following Concepts, Constructs, and/or Doctrines help in forming the basis for this treatment?

I. Constructive Receipt Doctrine.
II. All-inclusive Income Concept.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* b

69. John purchased State of Oklahoma general-purpose bonds at a cost of $3,400 in 2014. He receives $210 interest on the bonds in 2014, 2015, and 2016. In 2016, he sells the bonds for $3,800. How much income does John recognize in each of the following years?

| | 2014 | 2015 | 2016 |
|---|---|---|---|
| a. | -0- | -0- | -0- |
| b. | -0- | -0- | 400 |
| c. | 210 | 210 | 210 |
| d. | 210 | 210 | 570 |

*ANSWER:* b

70. Helen receives stock worth $1,000 from her grandfather as a graduation gift in May 2016 (her grandfather paid $100 for the stock many years ago). In December 2016, she receives a $100 cash dividend on the stock. Helen is not taxed on the value of the stock received in 2016, but she must include the $100 cash dividend in her 2016 gross income. Which of the following form the basis for this treatment?

I. Capital Recovery Concept.
II. Legislative Grace Concept.
III. All-inclusive Income Concept.
IV. Constructive Receipt Doctrine.

a. Statements II and III are correct.
b. Statements I and IV are correct.
c. Statements II, III, and IV are correct.
d. Statements II and IV are correct.
e. Only statement I is correct.

*ANSWER:* a

71. Nancy owns a truck she uses personally. It cost her $18,000 two years ago. Doug offers Nancy $19,000 for the truck. What would be the tax effects if the transaction is completed this year?

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I. Nancy will realize a capital gain of $1,000 due to the capital recovery concept.
II. Nancy must recognize income of $19,000 due to the all-inclusive-income concept.
III. Nancy must recognize a capital gain of $1,000 on her current-year tax return because there is no legislative provision to exclude this gain.
IV. Nancy will recognize no gain on her tax return due to lack of business purpose with the automobile.

a. Statements I and IV are correct.
b. Statements I, II, and III are correct.
c. Statements I and III are correct.
d. Statements II and IV are correct.
e. Only statement IV is correct.

*ANSWER:* c

72. Hank bought a small ranch for $300,000 in 2010. In 2016, oil is discovered on neighboring property. The county assessor re-valued Hank's property at $1,550,000. Hank does not recognize any income due to the
a. All-inclusive Income Concept.
b. Capital Recovery Concept.
c. Realization Concept.
d. Claim of Right Doctrine.
e. Ability-to-Pay Concept.

*ANSWER:* c

73. Wanda bought 5 acres of land near Antler Mountain 13 years ago for $5,000. Recently, the U.S. Forest Service announced that a new ski area would be built on Antler Mountain next year. Wanda receives a telephone call from a representative of Omni Ski Corporation offering her $100,000 for the property. She rejected the offer saying she plans to hold onto the property for her grandchildren. What are the tax effects of these events?
I. Wanda will not report income because of the increased value of the property on her tax return for this year.
II. Realization occurs when the offer is given to Wanda.
III. Ability to pay occurred when the offer was extended to Wanda.
IV. Recognition only occurs when a sale is completed because of the realization concept.

a. Statements I and II are correct.
b. Statements II and III are correct.
c. Only statement IV is correct.
d. Statements I and IV are correct.
e. Statements I, III, and IV are correct.

*ANSWER:* d

74. Dreamland Corporation purchased 10,000 shares of Sleepytime, Inc. common stock for $200,000 on February 19, 2015. On December 31, 2015, the value of the Sleepytime stock declines to $180,000. Dreamland sells the Sleepytime stock for $170,000 on January 10, 2016. Dreamland does not recognize a loss on the stock in 2015, but does recognize a loss of $30,000 in 2016. Which of the following Concepts, Constructs, and/or Doctrines form the basis for this treatment?
I. Realization Concept.
II. Related Party Provisions.
III. Capital Recovery Concept.
IV. Tax Benefit Rule.

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a. Statements I and II are correct.
b. Statements I and III are correct.
c. Statements II and IV are correct.
d. Statements I, II and III are correct.
e. Statements I, III and IV are correct.

*ANSWER:* b

75. Television station Channel 2 receives $200,000 from Harry's Auto Parts, Inc., to air Harry's commercials during a local automotive repair talk show in December 2016. December's ratings drop sharply when the show's star quits to work as a mechanic with a NASCAR team. Shortly thereafter, Harry contacts Channel 2 indicating that he wants to discontinue his sponsorship and requests return of $125,000 of the payment. The station continues to air the commercials and keeps the $200,000. Harry initiates a legal suit to recover the $125,000. Why is the $200,000 included in Channel 2's 2016 gross income?

I. All-inclusive Income Concept.
II. Capital Recovery Concept.
III. Wherewithal-To-Pay Concept.
IV. Claim of Right Doctrine.
V. Constructive Receipt Doctrine.

a. Only statement I is correct.
b. Only statement IV is correct.
c. Statements I, III, and IV are correct.
d. Statements I, III, and V are correct.
e. Statements II, III, and IV are correct.

*ANSWER:* c

76. Television station Channel 2 receives $200,000 from Harry's Auto Parts, Inc., to air Harry's commercials during a local automotive repair talk show in December 2016. December's ratings drop sharply when the show's star quits to work as a mechanic with a NASCAR team. Shortly thereafter, Harry contacts Channel 2 indicating that he wants to discontinue his sponsorship and requests return of $125,000 of the payment. The station continues to air the commercials and keeps the $200,000. Harry initiates a legal suit to recover the $125,000. Which of the following dictate that the $200,000 be included in Channel 2's 2016 gross income?

I. Capital Recovery Concept.
II. Claim of Right Doctrine.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* b

77. Joline is a cash basis taxpayer. A renter pays Joline the January 2016 rent in December 2015. What are the tax effects of this transaction?

I. Joline will recognize rent income for tax purposes in 2016.
II. The wherewithal-to-pay concept is the basis for Joline's recognition of the income in 2016.

a. Only statement I is correct.
b. Only statement II is correct.

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c. Both statements are correct.

d. Neither statement is correct.

*ANSWER:* d

78. In which of the following situations does the taxpayer have a claim of right to the payment received?

I. Ellen is on the Carlyle city council. She accepts $5,000 from a contractor who is seeking rezoning of his land before the commission on the condition that Ellen supports the rezoning. The payment is illegal under state law and Ellen will have to repay the $5,000 if the arrangement with the contractor is discovered.

II. Alan's automobile is damaged in an automobile accident. Because he uses the automobile in his job, his employer gives him $4,000 to have the car repaired. The employer will withhold $100 per paycheck until the $4,000 is repaid.

a. Only statement I is correct.

b. Only statement II is correct.

c. Both statements are correct.

d. Neither statement is correct.

*ANSWER:* a

79. The Claim-of-Right Doctrine

I. explains why Carla does not report $10,000 of income on her tax return when she borrows $10,000 from the First Savings Bank.

II. differs from the constructive receipt doctrine in that constructive receipt applies where an amount has been received, and the tax question is whether the amount is taxable in the current year.

III. explains why Samuel reports $45 of interest credited to his savings account on December 31, 2016, on his 2015 tax return, even though he does not actually receive the cash in 2016.

IV. applies when a taxpayer has no definitive obligation to repay the amount received.

a. Statements I and IV are correct.

b. Statements II and III are correct.

c. Statements II and IV are correct.

d. Statements I and III are correct.

e. Statements II, III, and IV are correct.

*ANSWER:* a

80. Sidney, a cash basis contractor, builds an apartment building for Jerry. The building is completed, and the bill is given to Jerry. Jerry pays $200,000 (1/4 of the bill) in 2016. Subsequently, Jerry files suit for damages based on alleged faulty construction. Sidney is required to recognize $200,000 of income in 2016 based upon

I. Constructive Receipt Doctrine.

II. Claim-of-Right Doctrine.

III. Realization Concept.

IV. Tax Benefit Rule.

a. Statements I and IV are correct.

b. Statements II and III are correct.

c. Only statement III is correct.

d. Statements I, II, and III are correct.

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e. Statements I, II, III, and IV.

*ANSWER:* b

81. Beth is an accrual basis taxpayer. A renter pays Beth the January 2016 rent in December 2015. What are the tax effects of this transaction?

I. Beth will recognize rent income in 2015.
II. The wherewithal-to-pay concept requires Beth to recognize the income in 2015.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* c

82. On December 20, 2016, Thomas, the CEO of Lifetime Corporation issues a $10,000 bonus check to Ana Maria. Thomas asks Ana Maria to hold the check until at least January 4, 2017, when there will be enough deposits to cover the check. Ana Maria is not required to recognize the $10,000 in 2016 because of which of the following?

a. Claim-of-Right Doctrine.
b. Substance-Over-Form Doctrine.
c. Entity Concept.
d. Constructive Receipt Doctrine.
e. Arm's Length Transaction Concept.

*ANSWER:* a

83. When Kerri filed her 2016 tax return on April 15, 2017, she did not include a $2,000 bonus received from her employer on January 10, 2017 relating to her work performance during 2016. What concept, construct, or doctrine supports Kerri's actions?

a. Arms-length Transaction Concept.
b. Substance Over Form Doctrine.
c. Constructive Receipt Doctrine.
d. Claim of Right.
e. Entity Concept.

*ANSWER:* c

84. Mario is an employee of Flores Company. The company regularly pays its employees by direct deposit on or before the last day of each month. Mario's regular paycheck is deposited on December 31, 2016, but Mario was away on vacation and didn't return until January 15, 2017. The gross amount of the check is included in Mario's 2016 income. Which of the following concepts or doctrines best explains this treatment?

a. Wherewithal-To-Pay Concept.
b. All-inclusive Income Concept.
c. Capital Recovery Concept.
d. Claim of Right Doctrine.
e. Constructive Receipt Doctrine.

*ANSWER:* e

85. Sandra directed her employer to withhold $500 of her wages each month for deposit to her mother's checking account. Which of the following concepts, constructs, or doctrines is the ***least*** helpful in determining how Sandra should report the

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arrangement for tax purposes?

a. Assignment of Income Doctrine.
b. Claim of Right Doctrine.
c. All-inclusive Income Concept.
d. Ability-to-pay Concept.
e. Constructive Receipt Doctrine.

*ANSWER:* d

86. Alexis, a cash basis contractor, builds a storage building for Jones. The building is completed, and the bill is given to Jones. Jones pays $60,000 in 2016. Subsequently, Jones files suit for damages based on alleged faulty construction. Alexis required to recognize $60,000 of income in 2016 based upon

I. Constructive Receipt Doctrine.
II. Claim-of-right Doctrine.

a. Only statement I is correct
b. Only statement II is correct
c. Both statements are correct
d. Neither statement is correct

*ANSWER:* b

87. In which of the following will the Constructive Receipt Doctrine require reporting income in 2016?

I. Cornell's December 2016 salary check is withheld until January 15, 2017, because the employer does not have sufficient cash to cover its December payroll.
II. Donnie is an employee of Holt Corporation. The corporation regularly mails payroll checks to employees to arrive on or before the last day of each month. Donnie's check arrives in the mail at his house on December 31, 2016. However, Donnie was vacationing in Cancun and did not return until January 8, 2017. Donnie deposited the check into his account the next day.
III. In December 2016, Cory signs a contract to play basketball for the Rhythms. He receives a signing bonus of $2,000,000 to be paid over 5 years beginning in 2017. His regular salary of $800,000 will be paid monthly during the season that begins in 2017.

a. Statements I, II, and III are correct.
b. Statements II and III are correct.
c. Statements I and II are correct.
d. Only statement II is correct.
e. Only statement III is correct.

*ANSWER:* d

88. The primary difference(s) between the claim-of-right doctrine and the constructive receipt doctrine is/are

I. Claim of right applies when the taxpayer has not yet physically received an item of income.
II. Constructive receipt applies after the taxpayer has received an item of income.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* d

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89. Arnold sells a parcel of investment real estate to Oswald for $600,000 in 2016. Arnold will receive $200,000 annually, plus interest at 8%, from 2017 through 2019. Arnold will recognize no gross income on this sale in 2016. Which of the following determines this treatment?

a. Administrative Convenience Concept
b. All-inclusive Income Concept.
c. Ability-To-Pay Concept.
d. Claim of Right Doctrine.
e. Wherewithal -to-Pay Concept.

*ANSWER:* e

90. It was stated in the text that realized gains from certain types of transactions (e.g., like-kind exchanges) are deferred for recognition in a future period. The basis of this treatment is the

I. Annual Accounting Period Concept.
II. Legislative Grace Concept.
III. Wherewithal-to-Pay Concept.
IV. Capital Recovery Concept.

a. Only statement II is correct.
b. Only statement III is correct.
c. Statements I and II are correct.
d. Statements II and III are correct.
e. Statements I, II, III and IV are correct.

*ANSWER:* d

91. Occasionally, realized gains are not recognized for tax purposes. These situations occur because

I. certain gains are excluded due to legislative grace.
II. gains are deferred on certain types of property transactions where the wherewithal-to-pay the tax resulting from the transaction is lacking.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* c

92. A corporation is allowed to deduct all of its ordinary and necessary business expenses. Which of the following Concepts is ***least*** helpful in determining this treatment?

a. All-inclusive Income Concept.
b. Entity Concept.
c. Capital Recovery Concept.
d. Legislative Grace Concept.
e. Business Purpose Concept.

*ANSWER:* a

93. Jane owns 100% of the stock of Lacy Corporation. Jane's son, Lee, is employed by Lacy Corporation as a consultant. Which of the following concepts or doctrines is ***least*** helpful in determining the tax consequences of any payments Lacy makes to Lee?

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a. Arm's-Length Transaction Concept.
b. Substance Over Form Doctrine.
c. Assignment of Income Doctrine.
d. Business Purpose Concept.
e. Entity Concept.

*ANSWER:* e

94. Deduction concepts need to resolve certain questions. Some of these are:
I. How much is deductible?
II. When can the deduction be taken?
III. What types of expenditures are deductible?
IV. What entity is entitled to the deduction?

a. Statements I and II are correct.
b. Statements II, III, and IV are correct
c. Statements I, II, and III are correct.
d. Only statement II is correct.
e. Statements I, II, III, and IV are correct.

*ANSWER:* e

95. Deduction concepts and constructs include which of the following?
I. Legislative Grace Concept.
II. Business Purpose Concept.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* c

96. Deduction concepts include which of the following?
I. Capital Recovery Concept.
II. Legislative Grace Concept.
III. Business Purpose Concept.
IV. Ability to Pay Concept.

a. Only statement I is correct.
b. Only statement II is correct.
c. Statements I and II are correct.
d. Statements I, II, and III are correct.
e. Statements I, II, III, and IV are correct.

*ANSWER:* d

97. Guzman Corporation has its expenditure of $700,000 for salary to its president and sole shareholder disallowed as a deduction by the IRS. Comparable salaries for presidents of similarly sized firms in the same industry average $300,000. The IRS reclassified $400,000 as a nondeductible cash dividend. Which of the following form the basis for the IRS disallowance?
I. Lack of Business Purpose.

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II. Administrative Convenience Concept.
III. Capital Recovery Concept.
IV. Substance over Form Doctrine.

a. Only statement I is correct.
b. Only statement IV is correct.
c. Statements I and IV are correct.
d. Statements I, II, and IV are correct.
e. Statements I, II, III, and IV are correct.

*ANSWER:* c

98. Tyrone sells his personal-use car that had cost $15,000 for $10,000. Why is the loss realized on this transaction disallowed as a deduction?
I. Legislative Grace is lacking.
II. Personal losses are disallowed.
III. Business purpose is lacking.

a. Only statement I is correct.
b. Only statement II is correct.
c. Only statement III is correct.
d. Statements I and II are correct.
e. Statements I, II, and III are correct.

*ANSWER:* e

99. Tax law generally disallows deductions for personal expenditures. However, due to legislative grace, there are certain exceptions to this general provision of tax law. These exceptions include
I. Itemized Deductions.
II. Standard Deduction amount.
III. Personal Exemption amounts.
IV. Dependency Exemption amounts.

a. Statements I and IV are correct.
b. Statements I, II, and III are correct.
c. Statements I and II are correct.
d. Statements I, II, III, and IV are correct.
e. Statements III and IV are correct.

*ANSWER:* d

100. Silvia is a single individual who has income of $80,000. Todd is a single individual who has income of $35,000. Neither of them itemizes their deductions. Both taxpayers will take a standard deduction of $6,300 in 2016. The concept that allows both Silvia and Todd to take this deduction is

a. Capital Recovery.
b. Administrative Convenience.
c. Entity.
d. Wherewithal to Pay.
e. Pay-as-You Go.

*ANSWER:* b

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101. Laurie's Lawn Service, Inc., purchases a heavy-duty tri-cut lawn mower on March 17, 2016, for $5,500. Under a special election, Laurie's expenses the $5,500 cost of the lawn mower in 2016. In July, a tire on the lawn mower is repaired at a cost of $450. Maintenance costs on the lawn mower for 2016 total $175. What is Laurie's basis in the lawn mower at the end of 2016?

a. $- 0 -
b. $450
c. $5,500
d. $5,950
e. $6,125

*ANSWER:* a

102. Monica's Lawn Service, Inc., purchases a heavy-duty tri-cut lawn mower on March 17, 2016, for $4,500. The depreciation on the lawn mower in 2016 was $500. In July, a tire on the lawn mower is repaired at a cost of $650. Maintenance costs on the lawn mower for 2016 total $175. What is Monica's basis in the lawn mower at the end of 2016?

a. $650
b. $4,000
c. $4,650
d. $5,150
e. $5,325

*ANSWER:* b

103. Monterey Developers purchases 10 acres of land for $15,000 on January 14, 2016. They also pay $2,000 in legal and other fees related to the purchase. Monterey spends $3,000 for legal fees, permit licenses, and city franchise fees to subdivide the land into 10 one-acre plots. Sewer and utility line easements cost an additional $5,000. Interest paid on the loan that financed the purchase is $1,200 for 2016. Monterey also pays $800 in property taxes in 2016. What is Monterey's adjusted basis in the land at the end of 2016?

a. $17,000
b. $25,000
c. $25,800
d. $26,200
e. $27,000

*ANSWER:* b

104. James purchased land costing $22,000 in 2015. He paid $2,000 in legal fees and other expenses to complete the purchase. In 2016, James spends $24,000 subdividing the land and running utilities to the property. Interest paid on the loan used to finance the purchase and subdividing total $1,750 in 2015 and $3,200 in 2016. James paid $350 of property taxes in 2015 and $750 of property taxes in 2016. What is James's basis in the land at the end of 2016?

a. $24,000
b. $46,000
c. $48,000
d. $50,950
e. $52,050

*ANSWER:* c

105. Drew Corporation purchased machinery costing $825,000 in 2015. Drew paid $5,000 for installation and testing of the machinery. Under a special election, Drew expensed $500,000 of the cost of the machinery in 2015. Drew also deducted depreciation on the machinery of $46,443 in 2015 and $79,593 in 2016. Drew's repair and maintenance costs on

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the machinery were $10,200 in 2015 and $13,300 in 2016. What is Drew Corporation's adjusted basis in the machinery at the end of 2016?

a. $175,468
b. $198,964
c. $203,964
d. $325,000
e. $698,964

*ANSWER:* b

106. Lauren owns an annuity that pays her $400 per month until she dies. Which of the following income tax concepts provides for the tax treatment of the annuity payments Lauren receives?

I. Annual Accounting Period Concept.
II. All-inclusive Income Concept.
III. Constructive Receipt Doctrine.
IV. Capital Recovery Concept.

a. Statements I and II are correct.
b. Statements II and III are correct.
c. Statements I and IV are correct.
d. Statements II, III, and IV are correct.
e. Only statement IV is correct.

*ANSWER:* d

107. Mandy is a self-employed plumber. She spends $24,000 of her personal savings to buy an Airstream camper to use on camping trips. Why is this expenditure not currently deductible?

I. It is a capital expenditure.
II. It is a personal expenditure.

a. Only statement I is correct.
b. Only statement II is correct.
c. Both statements are correct.
d. Neither statement is correct.

*ANSWER:* b

108. On March 3, 2013, Craig bought a business-use vehicle for $20,000. He used the vehicle for three years and properly deducted a total of $12,000 as depreciation expense during this period. At the end of 2016, Craig sells the vehicle for $7,500. Why is Craig's deductible loss $500?

I. Craig has already recovered $12,000 of his investment through the depreciation deduction.
II. The adjusted basis of the vehicle was $12,000 at the date of sale.
III. $7,500 of the adjusted basis was recovered because of the sale.
IV. The realized loss is recognized because it was incurred with business-use property.

a. Statements I and III are correct.
b. Statements I, III and IV are correct.
c. Statements II and III are correct.
d. Only statement IV is correct.
e. Statements I, II, III, and IV are correct.

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*ANSWER:* b

109. For each tax treatment described below, indicate which tax concept(s) that is (are) ***responsible*** for the treatment.

a. Kimberly, an accrual basis taxpayer, validly took a bad debt deduction of $850 in 2015 for an account receivable due from Cathy. In 2016, Cathy sent Kimberly a check for $500. Kimberly must include the $500 in her 2016 taxable income.

b. Randall, a cash basis taxpayer, receives $1,400 from Craig in December 2016. The $1,800 was for payment of the first and last month's rent ($700 per month) and a $400 cleaning deposit on a building Craig rented from Randall. Randall includes $1,400 in his 2016 taxable income.

c. Matt pays $14,000 rent on the office he uses in his computing firm. Matt is allowed to deduct the $14,000 on his tax return.

d. Samantha sells stock for $9,000 that she purchased two years earlier for $8,000. Samantha must report a capital gain of $1,000 on the sale.

e. Rosanne sells jewelry and some old clothes during the year. The jewelry cost $750 and is sold for $800. The clothes cost $500 and are sold for $150. Rosanne must include the $50 gain on the sale of her jewelry in her taxable income, but is not allowed to deduct the loss.

*ANSWER:* a. Tax Benefit Rule, Annual Accounting Period Concept.

b. Claim of Right Doctrine, Accounting Method, All-inclusive Income.

c. Business Purpose Concept, Capital Recovery Concept, Legislative Grace Concept.

d. All-inclusive Income Concept, Capital Recovery Concept, Legislative Grace Concept, Realization Concept.

e. All-inclusive Income Concept, Legislative Grace Concept, Capital Recovery Concept.

110. For each of the following tax treatments, explain the application of the income tax concept(s) that form the basis for the treatment.

a. Antonio uses his automobile 60% of the time in his insurance business and 40% of the time for personal purposes. Antonio is only allowed to deduct 60% of the cost of operating the automobile.

b. Teresa is a University student majoring in accounting. Teresa became a friend with her neighbor who owns an electronics store. In return for setting up an accounting system for her neighbor's store, Teresa is given an i-pod worth $600. Teresa must include the value of the i-pod in her gross income.

c. Larry bought 300 shares of Shamrock Common Stock in April for $6 per share. At December 31, Shamrock Common Stock is selling for $8 per share. Larry does not have to recognize any income from the Shamrock Common Stock in the current year.

d. Allan bought $10,000 Par Value of 8% Lake City Water Improvement District bonds for $9,200 several years ago. During the current year, Allan receives $400 in interest on the bonds before selling them for $9,600. Allan's only recognized income from the bonds is the $400 gain on the sale of the bonds.

e. Anita is an author of history books. In 2015, she signs a contract to write a book on the

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"History of the Tea Party." At that time, she received a $5,000 advance on her royalty payments. The terms of her contract require her to return the advance if she does not complete the book or if her royalties are insufficient to cover the advance. Anita finishes the book in 2015. Her total royalties from sales in 2016 are $12,000. Anita must include $5,000 in income in 2015 and $7,000 in income in 2016.

*ANSWER:* a. Business Purpose Concept for the 60% and the lack of the same for the 40% personal usage. Legislative Grace is necessary for any deduction.

b. All-inclusive Income Concept. Teresa provided a service and was compensated with something of value (cash-equivalent approach). The Realization Concept provides that Teresa recognizes the income once the exchange is complete.

c. The Realization Concept provides that no income is recognized until realization (sale of the stock) occurs.

d. The Realization Concept provides for the gain recognition on the sale of the bonds. The All-Inclusive-Income Concept provides for including income from the sale. The Capital Recovery Concept limits the gain to the amount realized in excess of the cost of the bonds. Legislative Grace provides for the exclusion from gross income of the interest from municipal bonds.

e. Under the Claim of Right Doctrine, income is recognized when it is received and there is no clear obligation to repay the income. The fact that Anita may have to repay the advance does not negate her claim of right or her ability to control the $5,000 advance. The Capital Recovery Concept states that income is not recognized until capital investment has been recovered. Because Anita has previously recognized the $5,000 advance, she does not recognize any income in 2016 until she recovers that investment amount.

111. For each of the following tax treatments, explain the income tax concept(s) which is/are *responsible* for the treatment indicated.

a. Dorine purchased 500 shares of Russell Corporation common stock in June 2015 for $11,000. In November 2015, Dorine received 50 shares of Russell Corporation stock as a stock dividend when the stock was selling for $22 per share. At December 31, 2015, the 550 Russell Corporation shares were worth $13,000. In March 2016, Dorine sells the 550 shares for $13,500. Dorine recognizes no income in 2015 and $2,500 of income in 2016 from her investment in Russell Corporation stock.

b. Steven is the sole owner of Moray Corporation. Steven sells land to Moray that cost him $33,000 for $22,000. Steven is not allowed to deduct the $11,000 loss on the sale.

c. Danielle is the owner of Larson Company. In April, she attends a trade show in New York. She takes her daughter with her on the trip so she can go to museums and see some Broadway shows. The cost of Danielle's trip is deductible, but her daughter's costs are not deductible.

d. Earl is a vice-president of Laddy Corporation. In December 2016, the board of directors voted to give Earl a $20,000 bonus, payable on December 30, 2016. Earl tells the payroll clerk to delay processing the bonus check until January 4, 2017. Earl must include the $20,000 bonus in his 2016 gross income.

*ANSWER:* a. The receipt of the stock dividend does not result in a Realization of income because Dorine's wealth has not increased. Similarly, the increase in market value at December 31 has not been Realized through an Arm's-Length Transaction with another party. The income from the sale of the stock constitutes a Realization and is subject to tax under the

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All-inclusive Income Concept. The Capital Recovery Concept provides for the recovery of her $11,000 investment against the $13,500 realization, resulting in a $2,500 gain on the sale.

b. Because Steven and Moray are Related Parties, they are not deemed to transact at Arms-length. Because the loss does not result from an Arms-length Transaction, it is not recognized for tax purposes.

c. Danielle's costs are deductible because they have a Business Purpose - they are related to her trade or business. Her daughter's costs are unrelated to any Business Purpose and are nondeductible personal expenses.

d. Earl is in Constructive Receipt of the bonus in 2016. The bonus was available for his use at that time, as evidenced by his ability to control the timing of the payment.

112. For each tax treatment described below, explain the income tax concept(s) which is (are) *responsible* for the treatment.

a. Leon sells stock to his sister Margie at a loss of $3,000. Leon is not allowed to deduct the $3,000 loss.

b. Jorge owns an appliance repair business. During the current year, he pays $5,000 of interest on the van he uses to call on customers and $5,000 of interest on his personal automobile. Jorge can deduct $5,000 of the interest.

c. Pepper Corporation, an accrual basis taxpayer, rents lawn equipment. In May of the current year, Pepper receives $4,000 from the rental of lawn equipment on 2-year rental contracts. Pepper must recognize the $4,000 income from the contracts in the current year.

d. Todd sells stock for $2,000 that he paid $3,500 for several years ago. After remodeling his residence, he sells all of his old furniture at a garage sale for $800. The furniture cost $4,000. Todd can deduct the $1,500 loss on the sale of the stock, but cannot deduct the loss on the furniture sale.

e. Marsha is single and earns $80,000 per year in her job as an executive vice-president for County Bank. Hasid is married, has two dependent children and earns $80,000 per year as a professor of history. Marsha's tax liability is $14,470. Hasid’s tax liability is $7,780.

*ANSWER:* a. Under the Arm's-Length Transaction Concept, only those transactions that are made at arms-length are given their intended tax effect. Related Parties are deemed not to transact at arms-length. Because Leon and Margie are related parties, the transaction is not made at arm's length and the loss is disallowed.

b. Legislative Grace restricts deductions to those that Congress has specifically allowed. Only those expenses that have a Business Purpose are generally allowed as deductions. The interest on the van has a Business Purpose and is deductible. The personal automobile interest does not have a Business Purpose and is not deductible. The Entity Concept requires Jorge to keep his business and personal transactions separate for reporting purposes. The Capital Recovery Concept limits the deductible amount to the $4,000 cost.

c. All taxpayers, both cash and accrual basis, must recognize rent in the period that it is received. The Wherewithal-to-Pay Concept states that the tax should be paid in the period in which the taxpayer has the resources to pay the tax. This requires accrual basis taxpayers to recognize prepaid income in the period of receipt.

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d. The Legislative Grace Concept requires Congress to approve of any form of tax relief. To be deductible, an expense or loss must have a Business Purpose. The stock is an investment asset and the loss derives from a business purpose. The furniture is a personal use asset that does not have a business purpose. The Capital Recovery Concept states that taxpayers are allowed to recover their investment before any income is recognized. Todd's loss on the stock represents his unrecovered capital investment.

e. The Ability to Pay Concept requires the tax to be based on the taxpayer's ability to pay the tax. Because Hasid supports four people on his income, his tax should be less than Marsha's (who has the same income and supports only herself). This is accomplished through Progressive Tax Rate Schedules for varying classes of taxpayers, different Standard Deduction amounts, and the allowance of Personal and Dependency Exemptions.

113. For each tax treatment described below, explain the income tax concept(s) which is (are) responsible for the treatment.

a. Atlas Construction Inc., an accrual basis taxpayer, billed a client $12,000 for services performed in December 2016. In March 2017, Atlas Construction receives a check from the client for $10,000. Included with the check is a letter indicating that some of the services had not been performed to specifications. After investigating the matter, Atlas Construction determined that the customer was right and corrected its account receivable with the client. Atlas Construction must include $12,000 in its 2016 income and takes a deduction for $2,000 in 2017.

b. Katie is the Mayor of Coal Creek. During the current year, she accepts $5,000 from a local banker for her promise that the banker would receive the contract for a new city bond issue. The payment is illegal under state law and will have to be returned if discovered. Katie must include the $5,000 in her gross income.

c. Little Company purchased machinery in 2012 at a cost of $40,000. In 2012 through 2016, Little properly deducts $14,000 in depreciation on the machinery. In 2016, the machinery is sold for $20,000. Little is allowed to deduct a $6,000 loss on the sale of the machinery.

d. In 2016 Raptor Corporation properly deducted a $5,000 expense it paid to Colfax Inc. In 2017 Raptor receives a $500 check from Colfax. A letter accompanying the check indicates that Colfax overcharged Raptor and the $500 refund was made to correct the overcharge. Raptor must include the $500 in its 2017 gross income.

*ANSWER:* a. Atlas Construction's accounting method (accrual basis) requires it to recognize income as it is earned. Because the $12,000 was billed (and not corrected) before the end of the year, the $12,000 must be included in 2016 income. Under the Annual Accounting Period Concept, each tax year stands separate and apart from all other tax years. Events of each year are accounted for separately and prior year's returns are not amended based on new information (only actual errors are corrected). In this case, the amount included in gross income for 2016 was correct as of the end of the year. The subsequent adjustment is taken up in 2017 as a deduction to adjust the over reporting of the 2016 income.

b. The All-Inclusive Income Concept requires all increases in wealth to be included in income, unless specifically excluded. There is no exclusion from income for bribes or kickbacks. Katie has a Claim of Right to the $5,000 when it is received. There is no definitive obligation to repay the $5,000 - it will only be repaid if discovered.

c. The Capital Recovery Concept allows Little to recover the $40,000 cost of its investment in the machinery. The $14,000 in depreciation is a capital recovery that reduces the adjusted basis of the machinery to $26,000. The sale results in a loss of $6,000 ($20,000 -

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$26,000). The $6,000 loss is unrecovered capital investment. Because Little is a trade or business, the Business Purpose Concept allows the deduction of the loss.

d. The Annual Accounting Period Concept requires the events of each year to stand separate and apart from other years. Because Raptor deducted the $500 in 2016, the $500 receipt in 2017 must be included in 2017 income under the Tax Benefit Rule. The prior year's deduction is not adjusted directly.

114. For each tax treatment described below, explain the income tax concept(s), which is (are) responsible for the treatment.

a. Amelia owns a 1/4 royalty interest in a uranium mine. Amelia has the owner of the mine pay 1/3 of her royalties to her son, Joel. During the current year, Amelia receives $18,000 and Joel receives $9,000 in royalty payments. Amelia has $27,000 of gross income from the royalty payments. Joel has no income.

b. Mark owns a weekend barbecue business. During the year, he purchases $900 of wood that he uses in his barbecue operation and in his personal fireplace. Mark can only deduct $550 of the wood cost as an expense of his barbecue business.

c. Andre is the sole owner of Woods Corporation. Woods sells Andre a parcel of land that it owned for $30,000. Woods had paid $45,000 for the land. Woods Corporation cannot deduct the $15,000 loss on the sale.

d. On February 20, 2015, Constance purchases 100 shares of Paris stock for $4,500. At December 31, 2015, the stock is worth $5,200. On November 8, 2016, Constance sells the stock for $5,800. Constance has no income from the stock in 2015 and a capital gain of $1,300 in 2016.

e. Barney is a consultant and is a cash basis taxpayer. On December 31, 2016, a client calls and offers to drop off a check for $1,000 in payment of his account on his way to lunch. Barney tells the client not to bother delivering it in person and instructs him to mail the check. Barney must include the $1,000 in his 2016 gross income.

*ANSWER:* a. Under the Assignment of Income Doctrine, income is taxed to the entity that earns the income or owns the property producing the income. Because Amelia owns the royalty interest, she cannot avoid taxation on the royalties by having them paid to her son.

b. The Entity Concept requires taxpayers to correctly identify expenses according to their use by the taxpayer. The Business Purpose Concept allows deduction of expenses that are profit motivated. Personal expenditures are generally not deductible. Mark can deduct the cost of the wood used in his barbecue business because it has a business purpose. The wood used in his personal fireplace is a nondeductible personal expense.

c. Only Arm's-length Transactions are given their intended income tax effect. A transaction that is not made at arm's length is generally disregarded. Related parties do not transact at arm's length. Andre and Woods Corporation are Related Parties (more than 50% ownership by Andre) and the corporation is not allowed to deduct the loss on the sale.

d. The Realization Concept requires income to be realized in an arm's-length transaction before it is recognized. The $700 increase in the market value of the stock at the end of 2015 has not been realized and is not included in Constance's 2015 gross income. When the stock is sold, a gain is realized. Under the Capital Recovery Concept, Constance is allowed to recover her $4,500 basis in the stock before she has any income (i.e., the full $5,800 selling price is not taxable).

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e. Cash basis taxpayers recognize income when it is actually or constructively received. Income is constructively received when the taxpayer has the ability to control the income. Barney is in constructive receipt of the $1,000 because it was made available to him on December 31. His ability to direct the receipt of the payment to the next year indicates that he has control of the income.

115. Determine whether the taxpayer has realized income in each of the following cases. Explain why there has (or has not) been a realization and when the income will be realized if there is not a current realization.

a. Jaime appears on a TV game show in December 2016. She wins $25,000 in cash and a new sailboat worth $12,000. She receives a check for the cash she won on December 28, 2016. However, the sailboat was not ready for her to pick up until the following February.

b. Barry owns 30% of Thurman Corporation. Thurman, an S corporation, reports a taxable income of $2,000,000 and pays cash dividends of $1,000,000 in 2016.

c. Yolanda signs a contract to be Athletic Director of Higgins University for 5 years. Upon signing the contract she receives a $50,000 bonus. The terms of the contract provide that Yolanda will have to repay the bonus if she terminates her relationship with the University before the end of the contract.

d. Randy was arrested for reckless driving. Because it was his third offense, his fine was set at $1,000. Randy's employer needed Randy at work, so he paid the fine. He told Randy that he would not have to repay the $1,000 if he was not arrested again.

*ANSWER:* a. Jaime has realized $25,000 of income in 2016. She has a Claim of Right to the cash when it is received. The value of the sailboat is not recognized until 2017. Even though she won the sailboat in 2016, Jaime is not in Constructive Receipt of the sailboat at the end of 2016 because it has not been made available for her use.

b. Thurman Corporation is a Conduit Entity. Therefore, Barry is deemed to realize income as Thurman realizes income. He will report his share, $600,000, of Thurman's income in 2016. The $300,000 of cash dividends he receives has been realized, but is not subject to tax because it is deemed to be a Capital Recovery of his investment in Thurman.

c. Yolanda has realized the $50,000 bonus when it is received. She has a Claim of Right to the bonus because she is not under a strict obligation to repay the bonus. The fact that she may have to repay the bonus is not a substantial restriction on her use of the bonus money.

d. Randy has realized income from the payment of the fine by his employer. He is in constructive receipt of the $1,000 and has no current obligation to repay it. He has a claim-of-right to the money.

116. Explain why the taxpayer in each of the following situations either does or does not have a Claim of Right to the income received.

a. Thomas works as a purchasing agent for Local City Government. During the current year, he takes a $5,000 kickback from a supplier seeking a lucrative contract with Local City. The kickback is illegal under State law and will have to be repaid to Local City if it is ever discovered.

b. Bernice is an agent for Drew, quarterback of the LA Tigers. During the current year, Bernice negotiates a new contract for Drew that includes a $5,000,000 signing bonus. Bernice receives the signing bonus from the Tigers and places it in her business account. As per her contract agreement with Drew, Bernice writes a check for $600,000 to Drew's

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mother, gives Drew a check for $3,900,000 and retains the remaining $500,000 as her standard 10% fee.

c. Karl, an attorney, is hired by Dominic Manufacturing Company to represent it in a lawsuit. Because the lawsuit will likely drag out for a number of years, Karl requests that Dominic Manufacturing pay him a retainer representing two years of services. Dominic Manufacturing agrees to pay the $150,000 retainer; however, Dominic insists that Karl agree to refund, pro-rata, any of the retainer fee not yet earned should Dominic decide to terminate their relationship.

*ANSWER:* a. Thomas has a Claim-of-Right to the $5,000. Although Thomas will have to repay the $5,000 if discovered, it has yet to be discovered. Therefore, there is no definitive obligation to repay currently.

b. Bernice has a Claim-of-Right to the $500,000 agent fee. She has no legal obligation to repay it to Drew. Bernice has no Claim-of-Right to the other $4,500,000. Contractually, Bernice must distribute the funds. Drew has a Claim-of-Right to the $5,000,000 since he earned it by signing the contract with the Tigers. It was Drew's choice to give his mother $600,000. Drew must recognize the entire $5,000,000 as gross income, but he will be allowed to deduct the $500,000 agent fee as a business expense. The $600,000 gift to his mother is not deductible.

c. Karl has a Claim-of-Right to the retainer. Although he may have to repay part of it, no definitive obligation to repay yet exists. No specific repayment amount can be identified.

117. Explain the similarities and differences of the Claim of Right doctrine and the Constructive Receipt doctrine.

*ANSWER:* Constructive Receipt applies when the taxpayer has not yet physically received an item of income. Whether the taxpayer has the income within his/her control is the determinative question. Claim of Right applies when the taxpayer has actually received the income. The question is whether the amount is currently taxable. If a binding or legal obligation to return the funds exists, then the income is not currently taxable.

118. Derek Builders, LLC, entered into a contract to do extensive remodeling work on Helen's house in October 2015. The bid cost of the job was $5,000 and Helen made a down payment of $2,000 in November 2016. Because Helen was short of cash, Derek agreed to accept payment of the remaining $3,000 when she receives her tax refund in 2017. Derek completed the work on the contract in December. Helen dies in May 2017 before she had paid Derek. Because Helen was heavily in debt when she died, the executor of Helen's estate told Derek that he would be lucky to get $1,000 when the estate was settled.

a. Derek Builders uses the accrual method of accounting. Based on the income tax concepts, explain how Derek should account for the contract.

b. In 2018, Derek Builders receives $1,500 from Helen's estate as final payment on the $3,000 amount owed. Based on the income tax concepts, explain how Derek should treat the $1,500 receipt in 2018.

*ANSWER:* a. Derek Builders must recognize the $5,000 contract price in 2017. Under the accrual method of accounting, income is recognized in the year in which it is earned. The income was earned when Derek's completed the contract in December. Under the Annual Accounting Period Concept, each tax year stands alone, separate and apart from other tax years. When Derek becomes aware that the full amount of Helen's debt will not be repaid, it should take a $2,000 ($3,000 - $1,000) bad debt deduction.

b. The Annual Accounting Period Concept does not allow Derek's to go back and amend prior year's returns when new information about an item becomes available. Derek must account for the transaction in 2018. In 2018, Derek now knows that the correct amount of

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the income from the contract is $3,500. Because Derek deducted $2,000 of the amount owed by Helen in 2017 as a bad debt, it has recognized only $3,000 of income. Under the Tax Benefit Rule, Derek Builders must recognize $500 of the 2017 bad debt deduction as income in 2018.

119. Robin owns an appliance store. Robin gives Tim a stereo unit to paint the front of her store building. The stereo unit, included in Robin's inventory at a cost of $400, normally retails for $700. If Tim had billed Robin for his work like he charged other customers, he would have sent Robin a bill for $600. Does Tim have income from the receipt of the stereo unit? If so, what amount should Tim report as gross income? Explain in terms of the Income Tax Concepts.

*ANSWER:* Under the All-inclusive Income Concept, all income received is taxable unless specifically excluded. Income can be received in any form; it does not have to be received in cash (cash-equivalent approach). Therefore, Tim realized income when he received the stereo unit because it resulted in an increase in his wealth and was the result of an Arms-length Transaction. Tim must include the $700 fair market value of the stereo in his gross income because that is the value he received in exchange for his services.

120. Fran Holloway is an active dealer in used automobiles. While preparing her income tax return, you notice that she purchased one automobile for $7,000 and sold it one month later for $5,800 to Brian Holloway Enterprises. Explain, in terms of the income tax concepts, why the $1,200 loss on the sale of the automobile may not be deductible.

*ANSWER:* If Fran and Brian Holloway Enterprises are related parties, the $1,200 loss on the sale would not be deductible. Because related parties are not deemed to transact at arm's-length, transactions between related parties are usually not given their intended tax effect. In addition, the substance over form doctrine would require the substance of the transaction to be recognized. If Fran and Brian are husband and wife (or brother and sister), the substance of the transaction would be a sale for $5,800 and a gift of $1,200.

121. At what three points in time might a given expenditure be deductible?

a. _____

b. _____

c. _____

*ANSWER:* a. As paid or incurred.

b. Over the life of the asset.

c. On disposition of the asset.

122. Belinda purchases a computer system costing $6,000. During the current year, 70% of the use of the computer is for keeping the books and records of her Plasticware business, 20% of the use is for tracking her investments, and 10% of the use is personal. Explain the treatment of the computer according to the income tax concepts.

*ANSWER:* The use of the computer in her Plasticware business and for managing her investments has a Business Purpose and she will be allowed a deduction for each use. However, because trade or business expenses are treated differently for tax purposes than investment expenses, she will have to account for each use separately under the Entity Concept. The personal use of the computer lacks a Business Purpose and is not deductible. The computer is a capital expenditure because it provides benefits that extend substantially beyond the end of the current year. Therefore, Belinda is not allowed a current deduction for the cost of the computer; she will be allowed a Capital Recovery on the business and investment use of the computer over its tax life using prescribed tax depreciation methods.

123. Carl purchased a building costing $120,000 in 2000 for use in his landscape business. In 2009, he built an addition to the building at a cost of $30,000. In 2012, a tornado damaged the building. The cost of repairing the building was $22,000 and Carl's insurance company paid $16,000 of the cost of the repairs. Depreciation deducted on the building for 2000

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through 2016 totaled $18,000. What is Carl's adjusted basis in the building at the end of 2016? Explain.

*ANSWER:* Carl's adjusted basis is $132,000 ($120,000 + $30,000 - $18,000). The cost of the building addition is a capital expenditure and must be added to the basis of the building. The depreciation deductions are a Capital Recovery of the cost of the building and reduce Carl's investment in the building. The tornado damage does not affect the basis of the building because the $22,000 cost of repairing the building is fully recovered through the receipt of the $16,000 of insurance proceeds and the $6,000 loss deduction he is allowed on the building.

124. Baron pays $4,000 in legal fees. Under what conditions can Baron deduct the legal fees?

*ANSWER:* To be deductible, an expense must have a Business Purpose that exceeds any tax avoidance motive. This is interpreted to mean that the expense be related to either a trade or business of the taxpayer or a production of income (investment) activity. Therefore, if the legal fees relate to Baron's trade or business or to an investment, he will be able to deduct the fees. If they relate to a personal activity, then they are not deductible.

125. On November 1, 2016, Milton Consultants Inc., enters into a 2-year lease agreement for the use of a photocopier. The lease agreement requires Milton Consultants to pay a fixed fee of $4,800 on November 1 and one cent for each copy made on a monthly basis. Milton made the $4,800 payment on November 1, 2016. It paid $450 on December 10, 2016 for copies made in November and $560 on January 12, 2017 for copies made in December. Milton Consultants Inc., uses the cash basis of accounting. Explain, in terms of the income tax concepts, the amount of the deduction for the use of the copier that Milton can take in 2016.

*ANSWER:* The copier has a Business Purpose and deductions for recurring expenditures can be taken as a cash basis taxpayer pays them. However, a cash basis taxpayer cannot deduct capital expenditures, in full, in the year they are paid. Capital expenditures must be capitalized and allocated to the periods that benefit from the expenditure. A capital expenditure is defined as any expenditure that has a benefit that extends substantially beyond the end of the tax year. Because the $4,800 fixed fee benefits 2016, 2017, and 2018, it must be capitalized and amortized as the benefit of the photocopier is received. Milton can deduct $400 [($4,800/ 24) × 2 months] of the fixed fee in 2016. In addition, it can deduct the $450 copy fee that is paid in December. The $560 copy fee is not deductible until 2017, the year of payment.

126. Kiki fell asleep one night while driving home from work and severely damaged her car. Repairs to the car cost $4,600. Her insurance company reimbursed her for $4,100 of the repairs. Has Kiki realized a loss? Under what conditions can she deduct the loss?

*ANSWER:* Kiki has realized a loss of $500 ($4,600 - $4,100) from the accident - a change in her wealth has occurred in an arm's-length transaction. However, all realized losses are not recognized for tax purposes. To deduct the loss, the car must have a business purpose. If the car is used solely for business purposes, Kiki can deduct the $500 loss. However, if the car is used for personal purposes, she may take a casualty loss of $500 as an itemized deduction, subject to applicable limitations.

127. Sidney owns unimproved land in Chicago, Illinois. In 2007, Sidney leased the land for 10 years to the U-Store-It Storage Company. The lease terms require annual lease payments of $12,000 that are paid at the beginning of each year. U-Store-It immediately constructed a storage facility on the leased land. The storage facility building was worth $105,000 when it was constructed. In 2016, the lease expires and legal ownership of the building reverts to Sidney. The building is worth $125,000 when the lease expires. Sidney has reported the lease income annually, but will not report any income from the improvements the lessee made to the building. Explain in terms of the income tax concepts why Sidney has reported his income in this manner.

*ANSWER:* Sidney has income each year from the lease payments received according to the All-inclusive Income Concept. Sidney will not have to recognize the value of the improvements until he sells the building as prescribed by the Realization Concept and the Wherewithal-to-Pay Concept. Sidney’s basis in the building is not increased by the amount of the improvements, since he neither paid for them nor recognized any income from the improvements.

*Match each term with the correct statement below.*

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a. Allocates income, losses, and deductions to its owners for inclusion in their personal returns.
b. Each tax unit must keep separate records and report the results of its operations separate and apart from other tax units.
c. Income from services must be taxed to the taxpayer rendering the service and income from property must be taxed to the owner of the property.
d. Any tax year that ends on the last day of a month other than December.
e. All taxpayers must report the results of their operations on an annual basis.
f. A tax year that ends on December 31.
g. A tax entity that is liable for the payment of tax.

128. Annual Accounting Period Concept
*ANSWER:* e

129. Assignment of Income
*ANSWER:* c

130. Calendar year
*ANSWER:* f

131. Conduit entity
*ANSWER:* a

132. Entity Concept
*ANSWER:* b

133. Fiscal year
*ANSWER:* d

134. Taxable entity
*ANSWER:* g

*Match each statement with the correct term below.*
a. Taxpayer reports income when received in cash or its equivalent and takes deductions as they are paid.
b. A deduction taken in one year that is recovered in a later year is reported as income in the year of recovery to the extent that the deduction reduced taxable income.
c. Taxpayer reports income as earned and deductions as incurred.
d. The result of an arms-length transaction.
e. Exclusions and deductions result from specific acts of Congress that must be strictly applied and interpreted.
f. The taxability of a transaction is determined by the reality of the transaction rather than some contrived appearance.
g. The reporting of an item of income or expense on a tax return
h. No income is realized until the taxpayer's invested capital is recovered.
i. All income received is taxable unless some specific provision of the tax law allows exclusion of the item.
j. These taxpayers are not deemed to transact at arms-length.

135. Accrual Method
*ANSWER:* c

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136. All-Inclusive Income Concept
*ANSWER:* i

137. Capital Recovery Concept
*ANSWER:* h

138. Cash Method
*ANSWER:* a

139. Legislative Grace Concept
*ANSWER:* e

140. Realization
*ANSWER:* d

141. Recognition
*ANSWER:* g

142. Related party
*ANSWER:* j

143. Substance Over Form Doctrine
*ANSWER:* f

144. Tax Benefit Rule
*ANSWER:* b

*Match each statement with the correct term below.*

a. Income is subject to tax when it is received without restrictions as to its use or disposition.
b. Income is considered received when it is credited to the taxpayer's account or made unconditionally available to the taxpayer.
c. A concept that is fundamental to the progressive tax rate structure.
d. To be deductible, an expenditure must be made for a business or economic purpose that is greater than any tax avoidance motive of the taxpayer.
e. The amount of a deduction may not exceed its cost.
f. Income should be recognized and a tax paid when the taxpayer has the resources to pay the tax.
g. A type of deductible expenditure that embodies the profit motive requirement.
h. Allows the omission of items from the tax base for which the costs of compliance exceeds the revenue generated.
i. A category of expenses that is specifically disallowed.

145. Administrative Convenience
*ANSWER:* h

146. Claim of Right Doctrine
*ANSWER:* a

147. Constructive Receipt Doctrine
*ANSWER:* b

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148. Ability-to-Pay Concept
*ANSWER:* c

149. Business Purpose Concept
*ANSWER:* d

150. Capital Recovery Concept
*ANSWER:* e

151. Wherewithal-to-Pay Concept
*ANSWER:* f

152. Investment Expense
*ANSWER:* g

153. Personal Expense
*ANSWER:* i

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