




## Review Questions and Final Exam

Course name:	<b>Investment Income and Expense-2009</b>
Course number:	100509
Number of questions:	Review 60 Final exam 60
Prerequisite:	None
Advance preparation:	None
Course level:	Basic
Recommended CPE credit:	10 CPE hours
Recommended study time:	10 hours
Course format:	Interactive self study CPE credit calculated as 100% of total study time (i.e. 50 minute hour)
Reference text:	IRS 2009 Publication 550 Investment Income and Expense (free download)  82 pages
 Department of the Treasury Internal Revenue Service	
Subject classification:	Taxation
Course updated:	February 3, 2010
Learning objective:	To review the tax treatment of investment income and expenses, including an explanation of what investment income is taxable and what investment expenses are deductible.  Also discussed are when and how to show these items on your tax return, as well as how to determine and report gains and losses on the disposition of investment property.
Instructions:	This copy of the exam can be used to answer questions while <b>offline</b> .  Please note that you will still need to <b>enter your answers online</b> by logging into the course system with your User ID and Password.

- 1) Investment expenses include college tuition paid on behalf of your children, since that can be considered "an investment in their future."  
True  
False
- 2) Interest, dividends and other investment income you receive as a beneficiary of an estate or trust is generally taxable income.  
True  
False
- 3) If your bank deducts backup withholding from your savings account interest income, the bank must give you an information return for the year, such as a Form 1099-INT.  
True  
False
- 4) If you receive a Form 1099-INT that shows an incorrect amount, the IRS does not suggest that you request a corrected form.  
True  
False
- 5) Dividends and interest are essentially the same thing and can be grouped together for tax reporting purposes.  
True  
False
- 6) Maryann received a microwave valued at \$50 for opening an account in a savings institution. She must report the value of this gift as interest.  
True  
False
- 7) A gift loan is a loan that is not expected to be paid back.  
True  
False
- 8) A demand loan is a loan available to the borrower "on demand" at any time (during normal banking hours).  
True  
False
- 9) If you buy a U.S. Savings Bond for Jim Smith (and put it in his name), who is the sole owner of the bond, then the bond interest must be reported by:  
a) You  
b) Jim Smith  
c) Both you and Jim Smith (one-half each)

d) You and your spouse

10) Qualified higher education expenses (in reference to the Educational Savings Bond Program) can not include tuition for your spouse to attend an eligible educational institution.

True

False

11) Life insurance proceeds paid to you as beneficiary of the insured person are usually not taxable.

True

False

12) Market discount on a tax-exempt bond is NOT tax-exempt.

True

False

13) The Original Issue Discount (OID) rules do NOT apply to short-term debt instruments.

True

False

14) A good way to hide income is to purchase a bearer CD.

True

False

15) If you renew a Certificate of Deposit at maturity, it is treated as a redemption and a purchase of a new certificate.

True

False

16) You CAN use Form 1040-EZ in which of the following situations?

a) You received a Form 1099-INT for interest on frozen deposits

b) Your interest income is \$325

c) You received interest from a seller-financed mortgage and buyer used the property as a home

17) Ms. Matthews purchases a home from Ms. Johnson. Ms. Johnson finances the mortgage on the home. Ms. Johnson must provide Ms. Matthews with her name, address and social security number (or EIN), or be subject to a penalty.

True

False

18) Corporate distributions can be

a) Cash

b) Stock

c) Stock rights

d) Services

e) Any of the above

19) Some mutual funds and REITs keep their long-term capital gains and pay tax on them. You must treat your share of these gains as distributions, even though you did not actually receive them.

True

False

20) A "scrip dividend" is defined as:

- a) A stock certificate for more than 100 shares
- b) A Standard Commitment-RIP for a deceased shareholder (issued to heirs)
- c) A handwritten stock dividend certificate issued
- d) A stock dividend issued in the form of a certificate for a fractional share

21) If you allow your life insurance premiums to be paid by your insurance company, using the policy dividends, these dividends are NOT taxed.

True

False

22) You should receive a Form 1099-DIV if you owned stock on which you received \_\_\_\_\_ in dividends and other distributions:

- a) Any amount greater than zero
- b) Any amount over \$1.00, if the stock is publicly held
- c) Any amount over \$10.00

23) If you received restricted stock for services as an independent contractor, the rules governing restricted stock treatment DO NOT apply and you DO NOT need to report the stock dividends as income from self-employment.

True

False

24) A "REMIC" is an entity that is formed for the purpose of buying rental real estate, usually foreclosures, for the purpose of generating rental income which is then passed through to the partners.

True

False

25) An investment club can use a member's social security number (usually the president of the club) when filing the investment club return.

True

False

26) Generally, an investment club is treated as a partnership for federal tax purposes unless it chooses otherwise.

True

False

27) A taxpayer donates an antique farm plow, valued at \$6,500 to a charity. The taxpayer can perform his own appraisal provided it is in writing.

True

False

28) Assuming there is no fraud involved, if you underpay your tax related to a tax shelter, you may be charged an accuracy-related penalty of \_\_\_\_\_ %.

- a) 10%

- b) 20%
- c) 39%
- d) 75%

29) If there is any underpayment of tax on your return due to fraud, a penalty of \_\_\_\_\_ % of the underpayment will be added to your tax:

- a) 10%
- b) 20%
- c) 39%
- d) 75%

30) You own one rental house but your main source of income is from your job at a fast-food restaurant. You actively drive by the rental house every week to see if it has been trashed or burned down. You use a management company to manage the property and keep it rented. This real estate investment is considered a passive activity.

- True
- False

31) You invest in soft drink vending machines, which you then place in front of dollar stores. You keep them stocked with weekly visits.

You borrow quite a bit of money to purchase the vending machines. The interest on these loans is deductible as investment interest expense.

- True
- False

32) Your deduction for investment interest expense is generally limited to the amount of your net investment income.

- True
- False

33) You purchase a bond at a premium, that yields tax exempt interest. The amortized premium can be applied to which of the following:

- a) You must reduce your basis in the bond by the amortization for the year
- b) You can use the annual amortization to offset your bond interest to reduce your taxable interest
- c) Either A or B

34) You subscribe to a fairly expensive newsletter that provides advice on investing in penny stocks, but you never do actually invest in any penny stocks. This subscription cost is deductible as a miscellaneous itemized deduction on Schedule A, subject to the normal 2% limit.

- True
- False

35) You can deduct accounting fees that are necessary to collect taxable income.

- True
- False

36) You work at a pet store full time, and like to invest in stocks to supplement your income. In an effort to "beat the market" you attend a technical charting seminar for investors at a local hotel.

The cost of this seminar is fully deductible as a miscellaneous itemized deduction, subject to the 2% limit.

- True
- False

37) A trade is a transfer of property for other property or services and may be taxed in the same way as a sale.

- True
- False

38) Mr. Robinson's neighbor died suddenly and left him his valuable comic book collection. This transaction is considered a taxable trade for tax purposes.

- True
- False

39) Which of the following is NOT considered a constructive sale of an appreciated financial position?

- a) Sell a stock, then immediately (within 24 hours) buy a different stock in the exact same industry
- b) Enter into a short sale of the same property
- c) You told your mother that you wanted to enter into a short sale of some IBM stock, which is a stock in your portfolio. Your mother enters into a short sale of IBM stock in her name, because you told her this is the best way for you to avoid taxes

40) Under the marked to market system, 100% of your capital gain or loss will be treated as a short-term capital gain or loss, regardless of how long you actually held the property.

- True
- False

41) Which of the following could not be your basis of investment property?

- a) Cost
- b) A bargain price, if it was for payment of services
- c) Fair market value

42) Which of the following methods is an acceptable method of calculating the basis in shares of stock (not mutual fund shares) sold, in a situation where you cannot adequately identify the shares you sell?

- a) First in, first out (FIFO)
- b) Last in, first out (LIFO)
- c) Full average cost (FAC)

43) Your company, Wild Pencils, buys and sells odd-looking mechanical pencils to CPA firms. You trade 5 cases of your big selling orange pencils for 5 cases of blue pencils with one of your competitors. This trade of inventory held for sale qualifies as a nontaxable like-kind exchange.

- True
- False

- 44) Which of the following would cause you to recognize a gain or loss, assuming they are the result of a corporate reorganization:
- a) Common stock given for your preferred stock
  - b) Preferred stock given for your common stock
  - c) Stock in one corporation given for stock in another corporation
  - d) Common stock given for your preferred sock plus 10% of the current common stock price in cash
- 45) Which of the following would probably result in a recognized gain or loss, assuming the insured or annuitant is the same under both contracts?
- a) Life insurance contract for another life insurance contract
  - b) Annuity contract for a life insurance contract
  - c) Annuity contract for an annuity contract
  - d) Life insurance contract for an annuity contract
- 46) Jim and Jenny get divorced and Jenny receives the house in the divorce settlement. Her basis in the house is the same as the adjusted basis was just prior to her receiving it.
- True
  - False
- 47) You could deduct a loss on the sale of property if the transaction is directly between you and which of the following:
- a) Your brother
  - b) Your uncle
  - c) Your grandma
  - d) Your youngest child
- 48) You wrote a literary masterpiece entitled "How I Made a Fortune in Stocks by Buying Low and Selling High." This composition would be considered a noncapital asset.
- True
  - False
- 49) On the sale of an annuity contract before its maturity date, the part of any gain that is based on interest accumulated on the contract is ordinary income.
- True
  - False
- 50) If you are an investor in small business investment company (SBIC) stock, a loss from the sale, trade or worthlessness of that stock is always considered a capital loss, not an ordinary loss.
- True
  - False
- 51) You inherit a small amusement park in Alaska and one month later sell the property for a \$50,000 gain. This gain is treated as a long-term capital gain.
- True
  - False
- 52) You sell 100 shares of your Krispy Kreme stock and tell your wife to immediately purchase 100 shares out of her separate brokerage account, which she does. She also stops by the local outlet and buys 4 dozen donuts for the office to help boost their profits. A wash sale has occurred.

True  
False

53) You loan your minor son some money to buy clothes for school. Surprisingly, he doesn't repay you. This is fully deductible as a nonbusiness bad debt.

True  
False

54) Jeremy sold 75 shares of Disney, then bought 100 shares the next day. Since the number of shares bought and sold do not match, no shares are classified as a wash sale.

True  
False

55) If you exercise a call option, you add the cost of the call option to the basis of the stock you bought.

True  
False

56) If you dispose of one position of your straddle at a loss, you can treat this loss as if it were a stand alone loss (i.e. it is fully deductible) if you don't sell the offsetting position in the same tax year.

True  
False

57) You can use the installment method to report a gain from the sale of stock or securities traded on an established securities market.

True  
False

58) Your annual capital loss deduction can never be more than:

- a) \$6,000 (\$3,000 if married filing separately)
- b) \$3,000 (\$1,500 if married filing separately)
- c) \$2,000 (\$1,000 if married filing separately)
- d) \$1,000, regardless of filing status

59) On August 31, 2009 Cheryl sold her collection of 182 Limoges collectible boxes on EBay for a significant gain. She used her gain to start buying up Beanie Babies at a steep discount off list. Her maximum capital gain rate on the sale of here collectibles will be \_\_\_\_\_ %.

- a) 28
- b) 25
- c) 15
- d) 5

60) If you are classified as a "day trader" you can deduct commissions and other costs of acquiring or disposing of securities on Schedule C (Form 1040).

True  
False

- 1) Investment income generally includes interest, dividend, capital gains and other types of distributions.  
True  
False
- 2) Lindsey, aged 9, has a stock portfolio including Disney, Mattel and Apple. She had \$925 investment income this year and no earned income. Form 8615 must be used to figure Lindsey's tax.  
True  
False
- 3) You can use Form 1040EZ when you have:
  - a) A gain or loss from exchanges of like investment property
  - b) Capital gain distributions
  - c) Savings bond interest you will exclude because of higher education expenses
  - d) Taxable interest that totals \$1,500 or less
- 4) An accuracy-related penalty of up to 47% can be charged for under-payments of tax due to negligence or disregard of rules or regulations or substantial understatement of tax.  
True  
False
- 5) Generally amounts you receive from money market funds should be reported as dividends, not as interest.  
True  
False
- 6) You have a two year CD which matures in December of next year. You cash in the CD in December of this year (one year early) and receive \$100 in interest, but pay a \$23 penalty. You should report your interest income as:
  - a) 123
  - b) 100
  - c) 77
- 7) If you buy a bond when interest has been defaulted or when the interest has accrued but has not been paid, that interest is NOT income and is NOT taxable as interest if paid later.  
True  
False
- 8) If you use the cash method of accounting, you generally report the interest on U.S. savings bonds (excluding series EE and series I bonds) when you receive the interest.  
True  
False
- 9) You may be able to exclude from income all or part of the interest you receive on the redemption of qualified U.S. savings bonds during the year if you pay qualified higher education expenses during the same year.  
True  
False

- 10) Your qualified dependent son wants to attend a computer repair vocational school instead of the local university. This vocational school may be considered an eligible educational institution for purposes of the Education Savings Bond Program.
- True
  - False
- 11) There is no adjusted gross income limit for the savings bond interest exclusion for educational expenses.
- True
  - False
- 12) Bonds issued by which of the following would most likely have taxable interest, assuming they are issued in the current year, are in registered form and are not federally guaranteed?
- a) Port Authorities
  - b) Microsoft Corporation
  - c) State of California
  - d) Qualified Volunteer Fire Department
- 13) Which of the following amounts would qualify as "de minimis" original issue discount (OID), assuming these are all 10-year bonds bought at issue?
- a) Original issue price \$750, stated redemption price at maturity \$1,000
  - b) Original issue price \$950, stated redemption price at maturity \$1,000
  - c) Original issue price \$1,800, stated redemption price at maturity \$2,000
  - d) Original issue price \$1,970, stated redemption price at maturity \$2,000
- 14) If you buy a Certificate of Deposit with a maturity of more than 1 year, you should report the total interest due over the life of the CD at the maturity of the CD, assuming the total interest due is paid at maturity.
- True
  - False
- 15) A market discount bond is which of the following:
- a) Any bond bought at original issue
  - b) Any U. S. savings bond
  - c) A bond whose value is less than its issue price
  - d) A bond whose value is greater than its issue price
- 16) You own a coupon bond and the coupon becomes due and payable on December 15th each year. A smart tax move is to delay mailing in the coupon for payment until January 1st of the following year, so that the interest is received in the subsequent year.
- True
  - False
- 17) You must report interest from an individual retirement arrangement (IRA) as tax-exempt interest, if such amount exceeds \$100,000 in any single year.
- True
  - False
- 18) If you are charged a penalty for the early withdrawal of funds before maturity, you can deduct that penalty in its entirety on Form 1040 even if it is more than your interest income.

True  
False

19) If stock is sold after a dividend is declared, but before it is paid, the owner of record must include the dividend in income.

True  
False

20) Distributions of stock dividends are taxable if which of the following apply:

- a) You have the choice to receive tickets to Disneyworld instead of stock
- b) The distribution is on preferred stock
- c) Both A and B are taxable

21) Which of the following ARE included in taxable income?

- a) Exempt-interest dividends you receive from a mutual fund
- b) Insurance policy dividends that the insurer keeps and uses to pay your premiums
- c) Dividends you receive on veterans' insurance policies
- d) None of the above are included in taxable income

22) Restricted stock is stock that you get from your employer for services you perform and that is fully transferable.

True  
False

23) A collateralized debt obligation (CDO) is a debt instrument, other than a REMIC regular interest that can be secured by:

- a) Property, plant and equipment
- b) Equipment leases
- c) Nothing—a CDO is typically unsecured

24) For tax purposes REMIC income or loss is not considered income or loss from a passive activity.

True  
False

25) An investment club does NOT need to have a written agreement, a charter or bylaws in order to be treated as an investment club for tax purposes.

True  
False

26) One of the great things about tax shelters is that the organizers do not need to maintain a list identifying each investor--thus you can be an anonymous investor.

True  
False

27) If you include any deduction on your tax return from an interest in a tax shelter required to be registered, you must report the registration number of that tax shelter.

True  
False

- 28) An understatement of tax is considered to be substantial if it is more than the greater of :
- a) 10 % of the tax required to be shown on the return or \$5,000
  - b) 20 % of the tax required to be shown on the return or \$5,000
  - c) 10 % of the tax required to be shown on the return or \$2,500
  - d) 20 % of the tax required to be shown on the return or \$2,500
- 29) Which of the following at-risk rules may apply to your income-producing activity?
- a) The higher the level of risk of losses in the activity, the higher your deduction will be.
  - b) If your income from the income-producing activity exceeds \$100,000 in a single year, the income will be 100% taxable, regardless of your level of risk (known as the "100/100 rule").
  - c) The % of income which is taxable is based on the % of income that is derived from a risky investment.
  - d) The amount of loss you can deduct is limited to the amount you risk losing in the activity.
- 30) You can use losses from passive activities to offset income from which of the following:
- a) Wages income
  - b) Portfolio income
  - c) Passive activities income
  - d) Any of the above
- 31) If you are a cash basis taxpayer, you can pay investment related interest up to a year in advance and deduct that interest in the year that you pay it.
- True
  - False
- 32) Investment income does not include the part of your child's interest income that you choose to report on your return.
- True
  - False
- 33) Leslie works full time for Starbucks, but occasionally buys stocks based on "hot tips" she gets from customers. She should deduct investment expenses (other than interest expenses) on Schedule C, because they are considered "business expenses."
- True
  - False
- 34) As a stockholder in Disney, you attend the stockholders' meeting held annually at Disneyworld. Fortunately, the expenses to attend this meeting are mostly deductible.
- True
  - False
- 35) To deduct your investment expenses, you must itemize deductions on Schedule A, Form 1040.
- True
  - False
- 36) Stocks, stock rights and bonds that became worthless during the tax year are treated as though they were sold on \_\_\_\_\_.
- a) The first day of the year
  - b) July 1st of the year (mid-year)
  - c) The last day of the year

- d) The day they became worthless
- 37) If you hold a section 1256 contract at the end of the tax year, you generally must treat it as sold at its fair market value on the last business day of the tax year.  
True  
False
- 38) You own a foreign currency contract which is considered a section 1256 contract, and do not plan to sell it until next year. For tax purposes it will be treated as having been sold at its fair market value on the last business day of this tax year.  
True  
False
- 39) Gains and losses from section 1256 contracts are reported on Schedule B.  
True  
False
- 40) If property is transferred to you from your spouse your basis is the fair market value on the date of the transfer.  
True  
False
- 41) If you participate in a dividend reinvestment plan and receive stock from the corporation at a discount, your basis is the discounted value of the stock.  
True  
False
- 42) You do not need to report the trade of like property on your tax return.  
True  
False
- 43) You work out a deal with your brother-in-law to trade your 250 shares of common stock in XYZ Corp. valued at \$100,000 for his 100 shares of preferred stock in XYZ Corp. valued at \$100,000. This is a taxable trade.  
True  
False
- 44) Your gain from the sale or trade of property to a related party will be capital gain, if the property can be depreciated by the party receiving it.  
True  
False
- 45) A coin or stamp collection would be classified as a noncapital asset.  
True  
False
- 46) You purchased several cases of copier paper and pens and pencils for your office staff to use during tax season. These items would be classified as a capital asset for purposes of determining whether there is a related capital or ordinary gain or loss.

True  
False

47) You bought quite a few Obama souvenirs during election year, since you are a big fan of his. You ran out of storage room and sold them all on Ebay for a large loss. You can deduct this loss on your tax return.

True  
False

48) A futures contract is a hedging transaction if you enter into the contract in the ordinary course of your business primarily to manage the risk of interest rate or price changes or currency fluctuations on borrowings, ordinary property or ordinary obligations.

True  
False

49) If you hold investment property more than \_\_\_\_\_, any capital gain or loss is a long-term capital gain or loss.

- a) 3 months
- b) 6 months
- c) 12 months
- d) 36 months

50) You loaned your neighbor \$75,000 to establish a worm habitat to raise fishing worms in his back yard, so you would have a ready supply of bait. Unfortunately all the worms escaped and he wasn't able to repay the loan. This loan would be considered a business bad debt, since the loan proceeds were used to start a business.

True  
False

51) A wash sale occurs when you sell stock at a loss and buy substantially identical stock within how many days?

- a) 10 days
- b) 30 days
- c) 60 days
- d) 90 days

52) If you have a loss because you did not exercise an option to buy or sell, you are considered to have sold or traded the option on the date that it expired.

True  
False

53) A straddle is any set of offsetting positions on personal property, such as stock options and contracts to buy stock.

True  
False

54) If you sold qualified securities to an employee stock ownership plan (ESOP) you may be able to postpone all or part of the gain on the sale if you meet certain conditions.

True  
False

55) You made a substantial profit on your last stock trade, so you take your stockbroker out to lunch at a fancy 5 star restaurant. You can deduct the cost of this meal as a "sale expense" related to your stock sale, and simply add 50% of the cost of the meal (due to the 50% deduction limit on business meals) to your cost basis as reported on Schedule D.

True

False

56) When reporting your capital gains and losses, sale expenses include all EXCEPT:

- a) Broker's fees
- b) Commissions
- c) Costs of insider trading info
- d) State and local transfer taxes

57) Your net long-term capital gain or loss on Schedule D includes any undistributed long-term capital gains from an REIT.

True

False

58) During a particularly hard luck year, Will Williams (the decedent) sustained a long-term capital loss of \$17,500 during his last tax year, when he sold his Remington Typewriter stock. After deducting the allowable capital loss amount on the final return filed for the decedent, the decedent's estate can deduct \_\_\_\_\_ % of this loss and/or carry it over to following years?

- a) 100
- b) 75
- c) 50
- d) None

59) The IRS will evaluate how often and in what transaction amounts you make trades when they are evaluating if you qualify as a person in the business of "a trader of securities."

True

False

60) To be considered a trader in securities, you must meet all of the following conditions except:

- a) You must have an office at a brokerage or day trader firm
- b) Your activity must be substantial
- c) You must carry on the activity with continuity and regularity
- d) You must seek to profit from daily market movements in the prices of securities