YAEGER CPA REVIEW

Tackling Tough Tasks in REG and BEC:

Property Transactions and Entities/ Written Communication SIMs

Tackling Tough Tasks in REG: Property Transactions

CPA Exam Blueprint Representative Task

Review asset transactions to determine the character (capital vs. ordinary) of the gain or loss for federal income tax purposes.

Calculate the amount of ordinary income and loss for federal income tax purposes.

Section 1231 Assets

The following assets qualify as Section 1231 property:

1) Depreciable personal property that is used in a trade or business or,
2) Real property used in a trade or business, and
3) Property must be held for more than one year.

Once designated as a Section 1231 asset:

- All Section 1231 gains are netted against all Section 1231 losses.
- If the net Section 1231 gain exceeds the net Section 1231 losses, the net gain is a Section 1231 gain, which is a long-term capital gain.
- If the net Section 1231 losses exceed the net Section 1231 gain, the net loss is a Section 1231 loss, which is an ordinary loss.

Personal property and real property used in a trade or business which are held for one year or less are not capital assets and are also not Section 1231 assets. If these assets are sold at a gain or loss, all gains or losses will be ordinary.

Section 1231 Assets

Example 1

If an individual (or sole proprietor) sold real property used in a trade or business, which was held for more than one year, none of the gain is recaptured as ordinary income. The entire gain is Section 1231 gain, long-term capital gain.

Example 2

If a corporation sold real property used in a trade or business, which was held for more than one year, the corporation must recapture 20% of the depreciation taken under Section 291 as ordinary income, with any balance of gain treated as Section 1231 gain, long-term capital gain.

Example Multiple Choice Question

The sale of which of the following types of business property should be reported as Section 1231 (Property Used in Trade or Business and Involuntary Conversions) property?

A. Inventory held for resale
B. Machinery held for six months
C. Cattle held for 6 months
D. Land held for 18 months

Answer: D

Section 1231 assets are personal property and real property used in a trade or business and must be held for more than 12 months.

Answer A is incorrect because inventory held for resale is not considered personal property.

Answer B is incorrect because the machinery must be held for more than 12 months to be a Section 1231 asset.

Answer C is incorrect because even though cattle are personal property used in a trade or business, they still must be held for more than 12 months to be a Section 1231 asset.

Section 1245 Assets

These assets are generally depreciable personal property, used in a trade or business or held for the production of income. These assets are held for one year or less. Examples include machinery equipment, trucks, and automobiles.

Section 1245 Recapture

The gain from the sale or exchange of a Section 1231 asset will be recaptured as ordinary income to the extent of the lesser of all depreciation taken or recognized gain. This recaptured gain is Section 1245 gain. The excess gain will be taxed as Section 1231 gain, which is a long-term capital gain. If the asset is disposed of at a loss, then the loss will be treated as a Section 1231 loss, which is an ordinary loss.

Example Multiple Choice Question

A taxpayer sold for $200,000 equipment that had an adjusted basis of $180,000. Through the date of sale, the taxpayer had deducted $30,000 of depreciation. Of this amount, $17,000 was in excess of straight-line depreciation. What amount of gain would be recaptured under Section 1245 (Gain from Dispositions of Certain Depreciable Property)?

A. $13,000
B. $17,000
C. $20,000
D. $30,000

Answer: C

When a business, whether a corporation or a sole proprietor, sells personal property used in a trade or business held for more than one year, the asset sold is a Section 1231 asset. The portion of the gain that is under Section 1231 is the long-term capital gain portion of the total gain.

Step 1 – Subtract the basis ($180,000) from the selling price ($200,000) to determine the actual gain ($20,000).

Step 2 – Use the lesser of the depreciation taken or the gain as the recaptured gain ($20,000).

Since all of the gain is recaptured as ordinary income under Section 1245, there is no remaining gain to be taxed under Section 1231 (long-term capital gain).

Tackling Tough Tasks in REG: Entities

CPA Exam Blueprint Representative Task

Calculate the realized and recognized gains (losses) by the partnership and partners of non-liquidating distributions from the partnership for federal income tax purposes.
Calculate the partner's basis of partnership assets received in a non-liquidating distribution for federal income tax purposes.

Partnership Gain/Loss Deferral

Partnerships generally do not recognize gain or loss on distributions, regardless of whether they are liquidating or non-liquidating, pro rata or non-pro rata.

Pro Rata Non-Liquidating (Current) Distributions

A pro rata non-liquidating, or current, distribution is a distribution to a continuing partners (including a draw by the partner) in accordance with the partner's ownership percentage. Current distributions so not terminate the partner's interest in the partnership. The basis of the property to the partner is the lesser of the partnership's basis in the property, or the partner's basis after the cash is subtracted from the beginning basis.

Partners **can only recognize gain on non-liquidating distributions of cash which exceeds the partner's basis in the partnership**. No losses are allowed to the partner in a non-liquidating distribution.

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Pro Rata Non-Liquidating (Current) Distributions - Continued

Hot assets are inventory and unrealized receivables as defined under IRC Section 751. These are basically ordinary income-producing assets, such as accounts receivable not already recognized as income, and appreciated inventory (which is not a capital asset). Hot assets generate ordinary income, when the partners sells their interest in the partnership.

Unrealized receivables generally are receivables of cash basis taxpayers.

Inventory is defined as any asset other than cash, capital assets, or Section 1231 assets. Deemed distributions (decreases in liabilities) are treated as cash distributions. Distributions of marketable securities, up to the value of the securities less than the partner's share of appreciation inherent in the securities, are treated as deemed distributions.

CPA Exam Blueprint Representative Task

Calculate the realized and recognized gains (losses) by the partnership and partners of liquidating distributions from the partnership for federal income tax purposes.
Calculate the partner’s basis of partnership assets received in a liquidating distribution for federal income tax purposes.

Pro Rata Liquidating Distributions

A liquidating distribution occurs when the entire partnership is liquidated, or the interest of one partner is redeemed. The distribution can occur in one or multiple transfers.

Like non-liquidating distributions, partners can only recognize a gain on liquidating distributions if cash exceeds the partner’s basis in the partnership. Similar to non-liquidating distributions, if a partner is relieved of a liability, it is treated as a cash distribution. A partner can recognize loss on a liquidating distribution if the partner receives either cash, unrealized receivables, and/or inventory, if these items received are less than the basis.

Example Multiple Choice Question

Anderson's basis in the SBF Partnership is $80,000. Anderson received a non-liquidating distribution of $50,000 cash, and land with an adjusted basis of $40,000 and a fair market value of $50,000. What is Anderson's basis in the land?

A. $50,000
B. $40,000
C. $30,000
D. $20,000

Answer: C

In non-liquidating multiple distributions of cash and non-cash property to a partner, first subtract the cash ($50,000) from the beginning basis ($80,000) which results in the remaining basis in the partnership of $30,000. Then, to determine the basis of the property to Anderson, take the lesser of the $30,000 (remaining basis after the cash is subtracted) or the basis of the land to the partnership ($40,000). The lesser amount of $30,000 is the basis of the land to the partner in a non-liquidating distribution.

Example Multiple Choice Question

Reid, Welsh, and May are equal partners in the RWM Partnership. Reid's basis in the partnership interest is $60,000. Reid receives a liquidating distribution of $61,000 cash, in addition to land with a fair market value of $14,000 and an adjusted basis of $12,000. What gain must Reid recognize upon the liquidation of his partnership interest?

A. $0
B. $1,000
C. $13,000
D. $15,000

Answer: B

In liquidation of a partnership interest where there are multiple distributions, first take the partner's basis in the partnership ($60,000) and subtract the cash ($61,000). Upon the liquidation of his partnership interest, gain only occurs to a partner if the money received by the partner exceeds his beginning basis. Since the partner received $61,000 in cash, which is greater than his beginning partnership interest of $60,000, his gain is $1,000. These gains are usually capital gains and after the cash of $61,000 is subtracted from the beginning basis of $60,000, the partner's basis is zero, because a partner can never have a negative basis in taxation.

Example Multiple Choice Question

Baker is a partner in BDT with a partnership basis of $60,000. BDT made a liquidating distribution of land with an adjusted basis of $75,000 and a fair market value of $40,000 to Baker. What amount of gain or loss should Baker report?

A. $35,000 loss
B. $20,000 loss
C. $0
D. $15,000 gain

Answer: C

Gain in a liquidating distribution is recognized if the partner receives cash in excess of his basis. Since there was no cash received, there can be no gain. Loss can be recognized in a liquidating distribution of a partner's interest through the receipt of only money, unrealized receivables, and inventory. These items must be less than the partner's basis in the partnership to have a recognized loss in total liquidation of a partner's interest. Loss is not recognized in the non-liquidation of a partner's interest.

Tackling Tough Tasks in BEC: Written Communications

BEC: Business Environment and Concepts

62 MCQs (50% of grade)
4 TBSs (35% of grade)
3 Written Communication Questions (15% of grade)

Only 2 of the 3 Written Communication Questions Will Count, BUT Do Not Guess Which 2!

- Written Communications Questions are only found in the BEC part of the Exam.
- Generally, Written Communications Questions consist of a case study involving a writing skills exercise.
- You are provided with a situation or scenario and asked to write a response to that situation or scenario.
- The response may include writing a letter or some type of memorandum providing the correct information about the situation or the scenario in a clear, complete, concise, and professional manner.

Tackling Tough Tasks in BEC: Written Communications

How to Maximize Points Earned on the 3 Written Communication SIMs?

- The AICPA is looking for strong introductory paragraphs, fact-based middle paragraphs addressing the situation or scenario including potential alternatives where applicable, and, finally, strong concluding paragraphs including framing and finishing an argument or your conclusion.
- Writing ability and grammar, including sentence and paragraph structure, are important when preparing your answer.
- You must remain on-topic when answering the question – do not wander off-topic.
- Do not copy and paste the situation or scenario word for word as part of your submission – paraphrase it, as required, when making your points in your letter or memorandum.
- Do not convey information in the form of a table, bullet point listing, or other type of abbreviated presentation.
- The expectation is that candidates know how to write and learned how to write in college. Spelling is important, but not absolutely critical.

Tackling Tough Tasks in BEC: Written Communications

How to Maximize Points Earned on the 3 Written Communication SIMs?

- USE the Exam program's spell check before you submit your final written answer for grading!
- REVIEW the sample Exam tests on the AICPA website!
- TRY grammarly.com to practice appropriate professional communication and writing structures, etc.
- MANAGE your time – you have 60 minutes to complete all 3 Written Communications or an average of 20 minutes per question.

Summary of What the Machine-Grader is Looking For

1. Clear
2. Concise
3. On topic
4. Proper grammar
5. Complete sentences
6. Organization
7. Supporting details
8. Proper formatting
9. Introductions and conclusions

Final Written Communication Tips

1. Manage your time.
2. Brainstorm.
3. Organize by creating an outline.
4. Write, making sure you address the question asked.
5. Proofread, proofread, proofread!
6. DON'T OVER THINK THE QUESTION OR YOUR ANSWER.

Now, Let's Go Through an Example From the Yaeger Material of a Written Communication Question and How to Approach It!

Tackling Tough Tasks in BEC: Written Communications

BEC Blueprint Area II – Economic Concepts and Analysis, Group C – Financial risk management

Joe Candle, the accounting manager of Zain Company, is confused as to when to use a risk-adjusted discount rate and a time-adjusted discount rate.

He has asked you to write a memorandum to him explaining the use of each one.

REMINDER: Your response will be graded for both technical content and writing skills. Technical content will be evaluated for information that is helpful to the intended reader and clearly relevant to the issue. Writing skills will be evaluated for development, organization, and the appropriate expression of ideas in professional correspondence. Use a standard business memo or letter format with a clear beginning, middle, and end. Do not convey information in the form of a table, bullet point list, or other abbreviated presentation.

Tackling Tough Tasks in BEC: Written Communications

Example Answer

To: Joe Candle, Accounting Manager, Zain Company
Re: Risk-Adjusted Discount Rate and Time-Adjusted Discount Rate

Dear Mr. Candle,

As you requested, here is an explanation of a risk-adjusted discount rate and a time-adjusted discount rate.

Risk-adjusted discount rates are used to account for the riskiness of a project. It adjusts for risk by applying different discount rates based on the level of risk involved in a given project. Typically, a project with a normal level of risk would be discounted at Zain's cost of capital. Likewise, projects with higher levels of risk would be discounted at higher rates. A method of applying a risk-adjusted discount rate is to establish a rate hierarchy depending on the risk. For example, low-risk projects (replace old machinery) would have a discount rate of 4%, medium-risk projects (launch a new product) would have a discount rate of 8%, and high-risk projects (open a new facility in a foreign country) would have a discount rate of 15%.

Time-adjusted discount rates are used to take into consideration the accuracy of forecasting financial information. For example, cash flows are much more difficult to forecast the further out in time. So, cash flows in the later years of a project's life are less likely to be as accurate as the cash flows in the earlier years. Because many variables can occur over time such as inflation, interest rates, and other economic conditions, cash flows in later years should be discounted at higher rates. For example, Zain might establish benchmark rates for specific time frames such as 8% for years 1 through 3, 10% for years 4 through 7, and 12% for years 8 through 10.

Keep in mind the purpose of discounting the project or investment. If you are looking at it from a risk management standpoint, you might consider a risk-adjusted discount rate. If you are looking to take into consideration various economic conditions in the future, the time-adjusted discount rate might be more appropriate.

If you have any other questions or require more information, please let me know.

Sincerely,
CPA Candidate

Tackling Tough Tasks in BEC: Written Communications

BEC Blueprint Area II – Economic Concepts and Analysis, Group B – Market influences on business

During a meeting with the accounting manager of a client, Best Meat Products, you are discussing general economic conditions related to demand for your client's products.

The conversation included that the demand curve is downward sloping and that a movement along the demand curve is caused by a change in price.

The accounting manager wasn't as comfortable discussing what happens to cause a shift in the demand curve, as he was in discussing movement along the demand curve.

The accounting manager asked you to write a memorandum describing the 2-3 main factors that would have a direct relationship in shifting the demand curve.

REMINDER: Your response will be graded for both technical content and writing skills. Technical content will be evaluated for information that is helpful to the intended reader and clearly relevant to the issue. Writing skills will be evaluated for development, organization, and the appropriate expression of ideas in professional correspondence. Use a standard business memo or letter format with a clear beginning, middle, and end. Do not convey information in the form of a table, bullet point list, or other abbreviated presentation.

Example Answer

To: Accounting Manager
Re: Direct Relationship Factors that Shift Demand Curve

Dear Accounting Manager,

This memorandum is in response to your request of me to describe the two to three main factors that would have a direct relationship in shifting the demand curve.

In reviewing any product and the economic environment it is sold in, it is important to consider the number of products produced compared to the actual market demand for those products. A shift in the demand curve occurs where there are changes in demand variable, other than price. There are economic conditions that have a direct relationship in shifting the demand curve for a product including the size of the market, expectations of a price increase, and the price of other substitute products.

The size of the market had a direct relationship in shifting the demand curve because as the size of the market increases, the demand for the product will increase. For example, this may occur when there is an increase in population or when the size of the typical customer base increases due to customers gaining wealth and moving up in the class scale.

I am available if you would like to discuss this in more detail. Thank you and please let me know if you have any more questions or need additional information.

Sincerely,
CPA Candidate

REMEMBER

1. Manage your time.
2. Brainstorm.
3. Organize by creating an outline.
4. Write, making sure you address the question asked.
5. Proofread, proofread, proofread!
6. DON'T OVER THINK THE QUESTION OR YOUR ANSWER.

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Two Important Things To Mention:

1. Please use Phil's online calendar to schedule a time to chat.
https://phil-yaeger.youcanbook.me/

2. We are currently running a BOGO sale!
Buy **ONE** single-part course bundle and get a **SECOND** for **50% off**!
Visit https://yaegercpareview.com/sale.cfm for more information.

Thank you!