

TEST BANK

Includes the American Recovery and Reinvestment Act of 2009

McGraw-Hill's
TAXATION *of* BUSINESS ENTITIES
2010 Edition



Brian **SILKER**

Ben **AYERS**

John **ROBINSON**

Ed **OUTSLAY**

Ron **WORSHAM**

John **BARRICK**

Carrie **WEAVER**

www.mhhe.com/silker2010

Chapter 02 Property Acquisition and Cost Recovery

True / False Questions

1. Like financial accounting, most business property must be capitalized for tax purposes.

True False

2. Tax cost recovery methods include depreciation, amortization, and depletion.

True False

3. If a business mistakenly claims too little depreciation, the business must only reduce the asset's basis by the depreciation actually taken rather than the amount of the allowable depreciation.

True False

4. An asset's capitalized cost basis includes only the actual purchase price; whereas the other expenses associated with the asset are immediately expensed.

True False

5. The basis for a personal use asset converted to business use is the lesser of the asset's cost basis or fair market value on the date of the transfer or conversion.

True False

6. Depreciation is currently computed under the Modified Accelerated Cost Recovery System (MACRS).

True False

7. The 200 percent or double declining balance method is allowable for five and seven year property.

True False

8. Taxpayers may use historical data to determine the recovery period for tax depreciation.

True False

9. Taxpayers use the half-year convention for all assets.

True False

10. If taxpayer places only one asset (a building) in service during the fourth quarter of the year, the mid-quarter convention must be used.

True False

11. The MACRS depreciation tables automatically switch to the straight-line method when it exceeds the declining balance method.

True False

12. If tangible personal property is being depreciated using the half-year convention and is disposed off during the first quarter of a subsequent year, the mid-year convention must be used in the year of disposition.

True False

13. If a machine (seven-year property) being depreciated using the half-year convention is disposed of during the seventh year, a taxpayer must multiply the appropriate depreciation percentage from the MACRS table percentage by 50 percent to calculate the depreciation expense properly.

True False

14. All taxpayers may use the section 179 immediate expensing election on certain property.

True False

15. The section 179 immediate expensing election phases out based upon a taxpayer's taxable income.

True False

16. The section 179 immediate expensing election phases out based upon a taxpayer's tangible personal property placed in service during the year.

True False

17. Property expensed under the section 179 immediate expensing election is not included in the 40 percent test to determine whether the mid-quarter convention must be used.

True False

18. In general, a taxpayer should select longer-lived property for the section 179 immediate expensing election.

True False

19. Occasionally bonus depreciation is used as a stimulus tool by tax policy makers.

True False

20. Business assets that tend to be used for both business and personal purposes are referred to as listed property.

True False

21. If the business use percentage for listed property falls below 50 percent, all future depreciation must be calculated under the straight-line method.

True False

22. Significant limits are placed on the depreciation of luxury automobiles.

True False

23. Real property is always depreciated using the straight-line method.

True False

24. The mid-month convention applies to real property in the year of acquisition and disposition.

True False

25. The alternative depreciation system requires both a slower method of recovery and longer recovery periods.

True False

26. The method for tax amortization is always the straight-line method.

True False

27. All assets subject to amortization have the same recovery period.

True False

28. Goodwill and customer lists are examples of section 197 amortizable assets.

True False

29. Taxpayers may always expense a portion of start-up costs and organizational expenditures.
True False

30. Businesses may immediately expense research and experimentation expenditures or they may elect to capitalize these costs and amortize them using the straight-line method over a period of not less than 60 months.
True False

31. The manner in which a business amortizes a patent or copyright is the same whether the business directly purchases the patent or copyright or whether it self-creates the intangible.
True False

32. Depletion is the method taxpayers use to recover their capital investment in natural resources.
True False

33. In general, oil and gas producers may take the greater of cost or percentage depletion.
True False

34. Cost depletion is available to all natural resource producers.
True False

35. Businesses deduct percentage depletion when they sell the natural resource and they deduct cost depletion in the year they produce or extract the natural resource.
True False

Multiple Choice Questions

36. Tax cost recovery methods do not include:

- A. Amortization
- B. Capitalization
- C. Depletion
- D. Depreciation
- E. All of the above are tax cost recovery methods

37. Which of the following is not depreciated?

- A. Automobile
- B. Building
- C. Patent
- D. Machinery
- E. All of the above are depreciated

38. Which of the following is not usually included in an asset's tax basis?

- A. Purchase price
- B. Sales tax
- C. Shipping
- D. Installation costs
- E. All of the above are included in an asset's tax basis

39. Which of the following would be considered an improvement rather than a routine maintenance?

- A. Oil change
- B. Engine overhaul
- C. Wiper blade replacement
- D. Change air filter

40. Tax depreciation is currently calculated under what system?

- A. Sum of the years digits
- B. Accelerated cost recovery system
- C. Modified accelerated cost recovery system
- D. Straight line system
- E. None of the above

41. Which is not an allowable method under MACRS?

- A. 150 percent declining balance
- B. 200 percent declining balance
- C. Straight line
- D. Sum of the years digits
- E. None of the above are allowable methods under MACRS

42. Which of the allowable methods allows the most accelerated depreciation?

- A. 150 percent declining balance
- B. 200 percent declining balance
- C. Straight line
- D. Sum of the years digits
- E. None of the above allow accelerated depreciation

43. How is the recovery period of an asset determined?

- A. Estimated useful life
- B. Treasury regulation
- C. Revenue Procedure 87-56
- D. Revenue Ruling 87-56
- E. None of the above

44. Which of the following depreciation conventions are not used under MACRS?

- A. Full-month
- B. Half-year
- C. Mid-month
- D. Mid-quarter
- E. All of the above are used under MACRS

45. Which depreciation convention is the general rule for tangible personal property?

- A. Full-month
- B. Half-year
- C. Mid-month
- D. Mid-quarter
- E. None of the above are conventions for tangible personal property

46. The MACRS recovery period for automobiles and computers is:

- A. 3 years
- B. 5 years
- C. 7 years
- D. 10 years
- E. None of the above

47. Lax, LLC purchased only one asset during the current year. It placed in service computer equipment (5-year property) on August 26 with a basis of \$20,000. Calculate the maximum depreciation expense for the current year (ignoring section 179 or bonus expensing):

- A. \$2,000
- B. \$2,858
- C. \$3,000
- D. \$4,000
- E. None of the above

48. Sairra, LLC purchased only one asset during the current year. It placed in service furniture (7-year property) on April 16 with a basis of \$25,000. Calculate the maximum depreciation expense for the current year, rounding to a whole number (ignoring section 179 or bonus expensing):

- A. \$1,785
- B. \$3,573
- C. \$4,463
- D. \$5,000
- E. None of the above

49. Beth's business purchased only one asset during the current year. It placed in service machinery (7-year property) on December 1 with a basis of \$50,000. Calculate the maximum depreciation expense (ignoring section 179 or bonus expensing):

- A. \$1,785
- B. \$2,500
- C. \$7,145
- D. \$10,000
- E. None of the above

50. Deirdre's business purchased two assets during the current year. It placed in service computer equipment (5-year property) on January 20 with a basis of \$15,000 and machinery (7-year property) on October 1 with a basis of \$15,000. Calculate the maximum depreciation expense, rounded to a whole number (ignoring section 179 or bonus expensing):

- A. \$1,286
- B. \$5,144
- C. \$5,786
- D. \$6,000
- E. None of the above

51. Suvi, Inc. purchased two assets during the current year. It placed in service computer equipment (5-year property) on August 10 with a basis of \$20,000 and machinery (7-year property) on November 18 with a basis of \$10,000. Calculate the maximum depreciation expense, rounded to a whole number (ignoring section 179 or bonus expensing):

- A. \$857
- B. \$3,357
- C. \$5,429
- D. \$6,000
- E. None of the above

52. Wheeler LLC purchased two assets during the current year. It placed in service computer equipment (5-year property) on November 16 with a basis of \$15,000 and furniture (7-year property) on April 20 with a basis of \$11,000. Calculate the maximum depreciation expense, rounding to a whole number (ignoring section 179 or bonus expensing):

- A. \$1,285
- B. \$2,714
- C. \$4,572
- D. \$5,200
- E. None of the above

53. Tasha LLC purchased furniture (7-year property) on April 20 with a basis of \$20,000 and used the mid-quarter convention. During the current year, which is the fourth year Tasha LLC owned the property, the property was disposed of on December 15. Calculate the maximum depreciation expense, rounding to a whole number:

- A. \$898
- B. \$2,095
- C. \$2,461
- D. \$2,394
- E. None of the above

54. Anne LLC purchased computer equipment (5-year property) on August 29 with a basis of \$30,000 and used the half-year convention. During the current year, which is the fourth year Anne LLC owned the property, the property was disposed of on January 15. Calculate the maximum depreciation expense:

- A. \$432
- B. \$1,728
- C. \$1,874
- D. \$3,456
- E. None of the above

55. Lenter LLC placed in service on April 29, 2009 machinery and equipment (7-year property) with a basis of \$400,000. Assume that Lenter has sufficient income to avoid any limitations. Calculate the maximum depreciation expense including section 179 expensing (but ignoring bonus expensing):

- A. \$57,160
- B. \$71,400
- C. \$171,154
- D. \$271,435
- E. None of the above

56. Littman LLC placed in service on July 29, 2009 machinery and equipment (7-year property) with a basis of \$400,000. Littman's income for the current year before expensing was \$100,000. Calculate the maximum depreciation expense including section 179 expensing (but ignoring bonus expensing):

- A. 0.
- B. \$57,160.
- C. \$142,870.
- D. \$271,435.
- E. None of the above.

57. Crouch LLC placed in service on May 19 machinery and equipment (7-year property) with a basis of \$900,000. Assume that Crouch has sufficient income to avoid any limitations. Calculate the maximum depreciation expense including section 179 expensing (but ignoring bonus expensing):

- A. \$128,610.
- B. \$156,894.
- C. \$257,175.
- D. \$342,885.
- E. None of the above.

58. Clay LLC placed in service machinery and equipment (7-year property) with a basis of \$1,000,000 on June 6, 2008. Assume that Clay has sufficient income to avoid any limitations. Calculate the maximum depreciation expense including section 179 expensing and bonus expensing, rounded to a whole number:

- A. \$142,900
- B. \$357,175
- C. \$592,878
- D. \$785,725
- E. None of the above

59. Bonnie Jo purchased a computer (5-year property) for use in her sole proprietorship. The basis of the computer was \$2,400. Bonnie Jo used the computer in her business 60 percent of the time and used it for personal purposes the rest of the time during the first year. Calculate Bonnie Jo's depreciation expense during the first year assuming the sole proprietorship had a loss during the year:

- A. \$240
- B. \$288
- C. \$480
- D. \$2,400
- E. None of the above

60. Billie Bob purchased a computer (5-year property) for use in his sole proprietorship in the prior year. The basis of the computer was \$2,400. Billie Bob used the computer in his business 60 percent of the time during the first year. During the second year, Billie Bob used the computer 40 percent for business use. Calculate Billie Bob's depreciation expense during the second year assuming the sole proprietorship had a loss during the year:

- A. \$0
- B. \$48
- C. \$192
- D. \$336
- E. None of the above

61. Potomac LLC purchased an automobile for \$30,000 on August 5th of 2008. What is Potomac's depreciation expense for 2008?

- A. \$2,960
- B. \$4,287
- C. \$6,000
- D. \$30,000
- E. None of the above

62. Arlington LLC purchased an automobile for \$40,000 on July 5th of 2008. What is Arlington's depreciation expense for 2008 if its business use percentage is 75 percent?

- A. \$2,220
- B. \$2,960
- C. \$6,000
- D. \$8,000
- E. None of the above

63. Poplock LLC purchased a warehouse and land during the current year for \$350,000. The purchase price was allocated as follows: \$275,000 to the building and \$75,000 to the land. The property was placed in service on August 12. Calculate Poplock's maximum depreciation for this first year, rounded to the nearest whole number:

- A. \$2,648
- B. \$3,371
- C. \$3,751
- D. \$4,774
- E. None of the above

64. Tom Tom LLC purchased a rental house and land during the current year for \$150,000. The purchase price was allocated as follows: \$100,000 to the building and \$50,000 to the land. The property was placed in service on May 22. Calculate Tom Tom's maximum depreciation for this first year:

- A. \$1,605
- B. \$2,273
- C. \$2,408
- D. \$3,410
- E. None of the above

65. Simmons LLC purchased an office building and land several years ago for \$250,000. The purchase price was allocated as follows: \$200,000 to the building and \$50,000 to the land. The property was placed in service on October 2. If the property is disposed of on February 27 during the 10th year, calculate Simmons' maximum depreciation in the 10th year:

- A. \$641
- B. \$909
- C. \$5,128
- D. \$7,346
- E. None of the above

66. Assume that Bethany acquires a competitor's assets on March 31st. The purchase price was \$150,000. Of that amount, \$125,000 is allocated to tangible assets and \$25,000 is allocated to goodwill (a §197 intangible asset). What is Bethany's amortization expense for the current year, rounded to the nearest whole number?

- A. \$0
- B. \$1,250
- C. \$1,319
- D. \$1,389
- E. None of the above

67. Assume that Brittany acquires a competitor's assets on September 30th of the prior year. The purchase price was \$350,000. Of that amount, \$300,000 is allocated to tangible assets and \$50,000 is allocated equally to two §197 intangible assets (goodwill and a 1-year non-compete agreement). Given, that the non-compete agreement expires on September 30th of year 2, what is Brittany's amortization expense for the second year, rounded to the nearest whole number?

- A. \$0
- B. \$1,667
- C. \$2,917
- D. \$3,333
- E. None of the above

68. Jasmine started a new business in the current year. She incurred \$10,000 of start-up costs. How much of the start-up costs can be immediately expensed for the year?

- A. \$0
- B. \$2,500
- C. \$5,000
- D. \$10,000
- E. None of the above

69. Racine started a new business in the current year. She incurred \$52,000 of start-up costs. If her business started on November 23rd of the current year, what is the total expense she may deduct with respect to the start-up costs for her initial year, rounded to the nearest whole number?

- A. \$2,555
- B. \$3,544
- C. \$5,522
- D. \$52,000
- E. None of the above

70. Daschle LLC completed some research and development during June of the current year. The related costs were \$60,000. If Daschle wants to capitalize and amortize the costs as quickly as possible, what is the total amortization expense Daschle may deduct during the current year?

- A. \$0
- B. \$6,500
- C. \$7,000
- D. \$12,000
- E. None of the above

71. Jorge purchased a copyright for use in his business in the current year. The purchase occurred on July 15th and the purchase price was \$75,000. If the patent has a remaining life of 75 months, what is the total amortization expense Jorge may deduct during the current year?

- A. \$0
- B. \$5,500
- C. \$6,000
- D. \$12,000
- E. None of the above

72. Geithner LLC patented a process it developed in the current year. The patent is expected to create benefits for Geithner over a 10 year period. The patent was issued on April 15th and the legal costs associated with the patent were \$43,000. In addition, Geithner had unamortized research expenditures of \$15,000 related to the process. What is the total amortization expense Geithner may deduct during the current year?

- A. \$2,417
- B. \$2,559
- C. \$4,108
- D. \$4,350
- E. None of the above

73. Santa Fe purchased the rights to extract turquoise on a tract of land over a five-year period. Santa Fe paid \$300,000 for extraction rights. A geologist estimates that Santa Fe will recover 5,000 pounds of turquoise. During the current year, Santa Fe extracted 1,500 pounds of turquoise, which it sold for \$200,000. What is Santa Fe's cost depletion expense for the current year?

- A. \$60,000
- B. \$90,000
- C. \$110,000
- D. \$300,000
- E. None of the above

74. Santa Fe purchased the rights to extract turquoise on a tract of land over a five-year period. Santa Fe paid \$300,000 for extraction rights. A geologist estimated that Santa Fe will recover 5,000 pounds of turquoise. During the past several years, 4,000 pounds were extracted. During the current year, Santa Fe extracted 1,500 pounds of turquoise, which it sold for \$250,000. What is Santa Fe's cost depletion expense for the current year?

- A. \$60,000
- B. \$90,000
- C. \$190,000
- D. \$160,000
- E. None of the above

75. Lucky Strike Mine (LLC) purchased a silver deposit for \$1,500,000. It estimated it would extract 500,000 ounces of silver from the deposit. Lucky Strike mined the silver and sold it reporting gross receipts of \$1.8 million, \$2.5 million, and \$2 million for years 1 through 3, respectively. During years 1 - 3, Lucky Strike reported net income (loss) from the silver deposit activity in the amount of (\$100,000), \$400,000, and \$100,000, respectively. In years 1 - 3, Lucky Strike actually extracted 400,000 ounces of silver as follows:

| Ounces extracted per year | | |
|----------------------------------|---------------|---------------|
| <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> |
| 50,000 | 150,000 | 100,000 |

What is Lucky Strike's depletion expense for year 2 if the applicable percentage depletion for silver is 15 percent?

- A. \$200,000
- B. \$375,000
- C. \$400,000
- D. \$450,000
- E. None of the above

Essay Questions

76. Janey purchased machinery on April 8th of the current year. The relevant costs for the year are as follows: machinery for \$10,000, \$800 shipping, \$50 for delivery insurance, \$500 for installation, \$750 for sales tax, \$150 for the annual tune up, and \$200 of property taxes (an annual tax on business property). What is Janey's tax basis for the machinery?

77. Jaussi purchased a computer several years ago for \$2,200 and used it for personal purposes. On November 10th of the current year, when the fair market value of the computer was \$800, Jaussi converted it to business use. What is Jaussi's tax basis for the computer?

78. Flax, LLC purchased only one asset during 2008. It placed in service an automobile (5-year property) on January 16 with a basis of \$14,000. Calculate the maximum depreciation expense (ignoring section 179 or bonus expensing).

79. Roth, LLC purchased only one asset during the current year. It placed in service computer equipment (5-year property) on November 1st with a basis of \$42,500. Calculate the maximum depreciation expense (ignoring section 179 or bonus expensing).

80. Eddie purchased only one asset during the current year. It placed in service furniture (7-year property) on May 1st with a basis of \$26,500. Calculate the maximum depreciation expense, rounded to the nearest whole number (ignoring section 179 or bonus expensing).

81. Teddy purchased only one asset during the current year. It placed in service machinery (7-year property) on October 1st with a basis of \$76,500. Calculate the maximum depreciation expense, rounded to the nearest whole number (ignoring section 179 or bonus expensing).

82. Amit purchased two assets during the current year. Amit placed in service computer equipment (5-year property) on April 16th with a basis of \$5,000 and furniture (7-year property) on September 9th with a basis of \$20,000. Calculate the maximum depreciation expense (ignoring section 179 or bonus expensing):

83. Yasmin purchased two assets during the current year. Yasmin placed in service computer equipment (5-year property) on May 26th with a basis of \$10,000 and machinery (7-year property) on December 9th with a basis of \$10,000. Calculate the maximum depreciation expense (ignoring section 179 or bonus expensing):

84. Bonnie Jo had two assets during the current year. The first was machinery with an original basis of \$15,000, currently in the second year of depreciation, and under the half-year convention. This asset was disposed of on October 1st of the current year. The second was furniture with an original basis of \$24,000 placed in service during the first quarter, currently in the fourth year of depreciation, and under the mid-quarter convention. What is Bonnie Jo's depreciation expense for the current year, rounded to the nearest whole number?

85. Kristine sold two assets on March 20th of the current year. The first was machinery with an original basis of \$51,000, currently in the fourth year of depreciation, and under the half-year convention. The second was furniture with an original basis of \$16,000 placed in service during the fourth quarter, currently in the third year of depreciation, and under the mid-quarter convention. What is Kristine's depreciation expense for the current year, rounded to the nearest whole number?

86. Timothy purchased a new computer for his consulting practice on October 15th of the current year. The basis of the computer was \$4,000. During the Thanksgiving holiday, he decided the computer didn't meet his business needs and gave it to his college-aged son in another state. The computer was never used for business purposes again. Timothy had \$50,000 of taxable income before depreciation. What is Timothy's total cost recovery expense with respect to the computer during the current year?

87. Olney LLC placed in service on July 19, 2009 machinery and equipment (7-year property) with a basis of \$600,000. Assume that Olney has sufficient income to avoid any limitations. Calculate the maximum depreciation expense including section 179 expensing, rounded to the nearest whole number (but ignoring bonus expensing).

88. Columbia LLC placed in service on October 9, 2009 machinery and equipment (7-year property) with a basis of \$950,000. Assume that Columbia has sufficient income to avoid any limitations. Calculate the maximum depreciation expense including section 179 expensing (but ignoring bonus expensing) for the year, rounded to the nearest whole number.

89. Northern LLC placed in service on September 6th machinery and equipment (7-year property) with a basis of \$900,000. Assume that Northern has sufficient income to avoid any limitations. Calculate the maximum depreciation expense including section 179 expensing and bonus expensing, rounded to the nearest whole number.

90. Assume that Reid has 2009 taxable income of \$150,000 before the §179 expense and acquired the following assets: he placed in service computer equipment (5-year property) on August 6th with a basis of \$100,000 and machinery (7-year property) on November 9th with a basis of \$100,000. Calculate the maximum depreciation expense including section 179 expensing (but not bonus expensing).

91. Phyllis purchased \$8,000 of specialized audio equipment that she uses in her business regularly. Occasionally, she uses the equipment for personal use. During the first year, Phyllis used the equipment for business use 70 percent of the time; however, during the current (second) year the business use fell to 40 percent. Assume that the equipment is seven-year MACRS property and is under the half-year convention. Assume the ADS recovery period is 10 years. What is the depreciation allowance for the current year, rounded to the nearest whole number?

92. Alexandra purchased a \$35,000 automobile during 2008. The business use was 70 percent. What is the allowable depreciation for the current year?

93. During August of the prior year, Julio purchased an apartment building that he used as a rental property. The basis was \$1,400,000. Calculate the maximum depreciation expense during the current year.

94. During April of the current year, Ronen purchased a warehouse that he used for business purposes. The basis was \$1,600,000. Calculate the maximum depreciation expense during the current year.

95. An office building was purchased on December 9th several years ago for \$2,500,000. The purchase price was allocated as follows: building \$1,900,000, landscaping \$100,000, and land \$500,000. During the current year, the 10th year, the building was sold on March 10th. Calculate the maximum depreciation expense for the real property during the current year, rounded to the nearest whole number.

96. Boxer LLC has acquired various types of assets recently. Below is a list of assets acquired during 2008 and 2009:

| <u>Asset</u> | <u>Cost Basis</u> | <u>Convention</u> | <u>Date Place in Service</u> |
|--------------------|-------------------|-------------------|------------------------------|
| Machinery | 25,000 | Half year | January 24, 2008 |
| Warehouse | 800,000 | Mid month | August 1, 2008 |
| Furniture | 100,000 | | October 5, 2009 |
| Computer equipment | 65,000 | | October 10, 2009 |
| Office equipment | 34,000 | | September 28, 2009 |
| Automobile | 35,000 | | July 15, 2009 |
| Office building | 800,000 | | September 24, 2009 |

Boxer did not elect section 179 expense or bonus depreciation in 2008, but would like elect section 179 expense for 2009 (assume that taxable income is sufficient). Calculate Boxer's maximum depreciation expense for 2009, rounded to the nearest whole number (ignore bonus depreciation for 2009).

97. Assume that Yuri acquires a competitor's assets on May 1st. The purchase price was \$500,000. Of the amount, \$325,000 is allocated to tangible assets and \$175,000 is allocated to goodwill (a §197 intangible asset). What is Yuri's amortization expense for the current year, rounded to the nearest whole number?

98. Assume that Cannon LLC acquires a competitor's assets on June 15th of a prior year. On May 30th of the second year, the customer list is sold for \$10,000. The purchase price was \$450,000. Of the amount, \$196,200 is allocated to tangible assets and \$253,800 is allocated to three §197 intangible assets: \$153,000 to goodwill, \$50,400 a customer list with an expected life of 8 years, and \$50,400 to a 3 year non-compete agreement. Please round your amortization amounts to the nearest whole number. Round your allocation percentage to the nearest whole percentage (e.g., .1234 as 12%)

- 1) What is Cannon's amortization expense for the second year?
- 2) What is the basis of the intangibles at the end of the second year?

99. Oksana started an LLC on November 2 of the current year. She incurred \$30,000 of start-up costs. How much of the start-up costs can be immediately expensed for the year? How much amortization may Oksana deduct in the first year?

100. Putin Corporation began business on September 23rd of the current year. It incurred \$40,000 of start-up costs and \$60,000 of organizational expenditures.

- 1) How much may be immediately expensed for the year?
- 2) How much amortization may be deducted in the first year, rounded to the nearest whole number?

101. Paulsen incurred \$55,000 of research and experimental expenses and began amortizing them over 60 months during June of year 1. During May of year 3, Paulsen received a patent based upon the research being amortized. \$36,000 of legal expenses for the patent was incurred.

- 1) What is the basis of the patent, rounding amortization for each year to the nearest whole number?
- 2) What is the amortization expense with respect to the patent during the year it was issued, rounded to the nearest whole number?

102. Sequoia purchased the rights to cut timber on several tracts of land over a fifteen year period. It paid \$500,000 for cutting rights. A timber engineer estimates that 500,000 board feet of timber will be cut. During the current year, Sequoia cut 45,000 board feet of timber, which it sold for \$900,000. What is Sequoia's cost depletion expense for the current year?

103. PC Mine purchased a platinum deposit for \$3,500,000. It estimated it would extract 17,000 ounces of platinum from the deposit. PC mined the platinum and sold it reporting gross receipts of \$500,000 and \$8 million for years 1 and 2, respectively. During years 1 and 2, PC reported net income (loss) from the platinum deposit activity in the amount of (\$100,000) and \$3,800,000, respectively. In years 1 and 2, PC actually extracted 2,000 and 8,000 ounces of platinum. What is PC's depletion expense for years 1 and 2 if the applicable percentage depletion for platinum is 22 percent, rounded to the nearest whole number?

Chapter 02 Property Acquisition and Cost Recovery **Answer Key**

True / False Questions

1. Like financial accounting, most business property must be capitalized for tax purposes.

TRUE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 1
Level of Difficulty: Easy*

2. Tax cost recovery methods include depreciation, amortization, and depletion.

TRUE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 1
Level of Difficulty: Easy*

3. If a business mistakenly claims too little depreciation, the business must only reduce the asset's basis by the depreciation actually taken rather than the amount of the allowable depreciation.

FALSE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 1
Level of Difficulty: Medium*

4. An asset's capitalized cost basis includes only the actual purchase price; whereas the other expenses associated with the asset are immediately expensed.

FALSE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 1
Level of Difficulty: Medium*

5. The basis for a personal use asset converted to business use is the lesser of the asset's cost basis or fair market value on the date of the transfer or conversion.

TRUE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 1
Level of Difficulty: Medium*

6. Depreciation is currently computed under the Modified Accelerated Cost Recovery System (MACRS).

TRUE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Easy*

7. The 200 percent or double declining balance method is allowable for five and seven year property.

TRUE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Easy*

8. Taxpayers may use historical data to determine the recovery period for tax depreciation.

TRUE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 3
Level of Difficulty: Easy*

9. Taxpayers use the half-year convention for all assets.

FALSE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium*

10. If taxpayer places only one asset (a building) in service during the fourth quarter of the year, the mid-quarter convention must be used.

FALSE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium*

11. The MACRS depreciation tables automatically switch to the straight-line method when it exceeds the declining balance method.

TRUE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium*

12. If tangible personal property is being depreciated using the half-year convention and is disposed off during the first quarter of a subsequent year, the mid-year convention must be used in the year of disposition.

FALSE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

13. If a machine (seven-year property) being depreciated using the half-year convention is disposed of during the seventh year, a taxpayer must multiply the appropriate depreciation percentage from the MACRS table percentage by 50 percent to calculate the depreciation expense properly.

TRUE

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 2
Level of Difficulty: Medium

14. All taxpayers may use the section 179 immediate expensing election on certain property.

FALSE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Easy

15. The section 179 immediate expensing election phases out based upon a taxpayer's taxable income.

FALSE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Easy

16. The section 179 immediate expensing election phases out based upon a taxpayer's tangible personal property placed in service during the year.

TRUE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Easy

17. Property expensed under the section 179 immediate expensing election is not included in the 40 percent test to determine whether the mid-quarter convention must be used.

TRUE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Difficult

18. In general, a taxpayer should select longer-lived property for the section 179 immediate expensing election.

TRUE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Easy

19. Occasionally bonus depreciation is used as a stimulus tool by tax policy makers.

TRUE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Easy

20. Business assets that tend to be used for both business and personal purposes are referred to as listed property.

TRUE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

21. If the business use percentage for listed property falls below 50 percent, all future depreciation must be calculated under the straight-line method.

FALSE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

22. Significant limits are placed on the depreciation of luxury automobiles.

TRUE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Easy

23. Real property is always depreciated using the straight-line method.

TRUE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Easy

24. The mid-month convention applies to real property in the year of acquisition and disposition.

TRUE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Easy*

25. The alternative depreciation system requires both a slower method of recovery and longer recovery periods.

FALSE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Application
Learning Objective: 2
Level of Difficulty: Hard*

26. The method for tax amortization is always the straight-line method.

TRUE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 3
Level of Difficulty: Easy*

27. All assets subject to amortization have the same recovery period.

FALSE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 3
Level of Difficulty: Easy*

28. Goodwill and customer lists are examples of section 197 amortizable assets.

TRUE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 3
Level of Difficulty: Medium

29. Taxpayers may always expense a portion of start-up costs and organizational expenditures.

FALSE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 3
Level of Difficulty: Medium

30. Businesses may immediately expense research and experimentation expenditures or they may elect to capitalize these costs and amortize them using the straight-line method over a period of not less than 60 months.

TRUE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 3
Level of Difficulty: Easy

31. The manner in which a business amortizes a patent or copyright is the same whether the business directly purchases the patent or copyright or whether it self-creates the intangible.

FALSE

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 3
Level of Difficulty: Medium

32. Depletion is the method taxpayers use to recover their capital investment in natural resources.

TRUE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 4
Level of Difficulty: Easy*

33. In general, oil and gas producers may take the greater of cost or percentage depletion.

FALSE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 4
Level of Difficulty: Medium*

34. Cost depletion is available to all natural resource producers.

TRUE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 4
Level of Difficulty: Medium*

35. Businesses deduct percentage depletion when they sell the natural resource and they deduct cost depletion in the year they produce or extract the natural resource.

TRUE

*AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 4
Level of Difficulty: Medium*

Chapter 02 - Property Acquisition and Cost Recovery

Multiple Choice Questions

36. Tax cost recovery methods do not include:

- A. Amortization
- B. Capitalization**
- C. Depletion
- D. Depreciation
- E. All of the above are tax cost recovery methods

Amortization, depletion, and amortization are cost recovery methods as a result of asset capitalization

AACSB: Reflective thinking

AICPA: Critical thinking

Bloom's: Knowledge

Learning Objective: 1

Level of Difficulty: Easy

37. Which of the following is not depreciated?

- A. Automobile
- B. Building
- C. Patent**
- D. Machinery
- E. All of the above are depreciated

Patents are amortized rather than depreciated.

AACSB: Reflective thinking

AICPA: Critical thinking

Bloom's: Knowledge

Learning Objective: 1

Level of Difficulty: Easy

38. Which of the following is not usually included in an asset's tax basis?

- A. Purchase price
- B. Sales tax
- C. Shipping
- D. Installation costs
- E. All of the above are included in an asset's tax basis**

The purchase price, sales tax, shipping, and installation costs are all included in an asset's tax basis.

AACSB: Analytic, Reflective thinking

AICPA: Critical thinking

Bloom's: Analysis

Learning Objective: 1

Level of Difficulty: Easy

39. Which of the following would be considered an improvement rather than a routine maintenance?

- A. Oil change
- B. Engine overhaul**
- C. Wiper blade replacement
- D. Change air filter

The engine overhaul is an improvement because it extends the useful life of the asset while the other items are routine maintenance.

AACSB: Analytic

AICPA: Critical thinking

Bloom's: Analysis

Learning Objective: 1

Level of Difficulty: Easy

40. Tax depreciation is currently calculated under what system?

- A. Sum of the years digits
- B. Accelerated cost recovery system
- C. Modified accelerated cost recovery system**
- D. Straight line system
- E. None of the above

The modified accelerated cost recovery system (MACRS) is the current tax depreciation system.

AACSB: Reflective thinking

AICPA: Critical thinking

Bloom's: Knowledge

Learning Objective: 2

Level of Difficulty: Easy

41. Which is not an allowable method under MACRS?

- A. 150 percent declining balance
- B. 200 percent declining balance
- C. Straight line
- D. Sum of the years digits**
- E. None of the above are allowable methods under MACRS

The sum of the years digits is not an allowable method under MACRS.

AACSB: Reflective thinking

AICPA: Critical thinking

Bloom's: Knowledge

Learning Objective: 2

Level of Difficulty: Easy

42. Which of the allowable methods allows the most accelerated depreciation?

- A. 150 percent declining balance
- B. 200 percent declining balance**
- C. Straight line
- D. Sum of the years digits
- E. None of the above allow accelerated depreciation

The 200 percent declining balance method allows the most depreciation expense.

AACSB: Reflective thinking

AICPA: Critical thinking

Bloom's: Analysis

Learning Objective: 2

Level of Difficulty: Easy

43. How is the recovery period of an asset determined?

- A. Estimated useful life
- B. Treasury regulation
- C. Revenue Procedure 87-56**
- D. Revenue Ruling 87-56
- E. None of the above

Revenue Procedure 87-56 helps taxpayers determine the recovery period for assets.

AACSB: Reflective thinking

AICPA: Critical thinking

Bloom's: Analysis

Learning Objective: 2

Level of Difficulty: Medium

44. Which of the following depreciation conventions are not used under MACRS?

- A.** Full-month
- B. Half-year
- C. Mid-month
- D. Mid-quarter
- E. All of the above are used under MACRS

The full month convention is used for tax amortization which does not fall under MACRS depreciation.

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

45. Which depreciation convention is the general rule for tangible personal property?

- A. Full-month
- B.** Half-year
- C. Mid-month
- D. Mid-quarter
- E. None of the above are conventions for tangible personal property

The half-year convention is the general rule for tangible personal property, while the mid-quarter convention is the exception.

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Easy

46. The MACRS recovery period for automobiles and computers is:

- A. 3 years
- B. 5 years**
- C. 7 years
- D. 10 years
- E. None of the above

These assets recovery period is 5 years.

AACSB: Reflective thinking
AICPA: Critical thinking
Bloom's: Knowledge
Learning Objective: 2
Level of Difficulty: Easy

47. Lax, LLC purchased only one asset during the current year. It placed in service computer equipment (5-year property) on August 26 with a basis of \$20,000. Calculate the maximum depreciation expense for the current year (ignoring section 179 or bonus expensing):

- A. \$2,000
- B. \$2,858
- C. \$3,000
- D. \$4,000**
- E. None of the above

The asset's recovery period is 5 years and the half-year convention applies. The calculation is $\$20,000 \times .2 = \$4,000$.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Easy

48. Sairra, LLC purchased only one asset during the current year. It placed in service furniture (7-year property) on April 16 with a basis of \$25,000. Calculate the maximum depreciation expense for the current year, rounding to a whole number (ignoring section 179 or bonus expensing):

- A. \$1,785
- B. \$3,573
- C. \$4,463**
- D. \$5,000
- E. None of the above

The asset's recovery period is 7 years and the half-year convention applies. The calculation is $\$25,000 \times .1429 = \$3,573$.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Easy

49. Beth's business purchased only one asset during the current year. It placed in service machinery (7-year property) on December 1 with a basis of \$50,000. Calculate the maximum depreciation expense (ignoring section 179 or bonus expensing):

- A. \$1,785**
- B. \$2,500
- C. \$7,145
- D. \$10,000
- E. None of the above

The asset's recovery period is 7 years and the mid-quarter convention applies because the property was placed in service during the fourth quarter. The calculation is $\$50,000 \times .0357 = \$1,785$.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 2
Level of Difficulty: Medium

50. Deirdre's business purchased two assets during the current year. It placed in service computer equipment (5-year property) on January 20 with a basis of \$15,000 and machinery (7-year property) on October 1 with a basis of \$15,000. Calculate the maximum depreciation expense, rounded to a whole number (ignoring section 179 or bonus expensing):

- A. \$1,286
- B. \$5,144
- C. \$5,786**
- D. \$6,000
- E. None of the above

The mid-quarter convention applies. The computer is 1st quarter property and the machinery is 4th quarter property. The calculations are $\$15,000 \times .35 = \$5,250$ and $\$15,000 \times .0357 = \536 . The total is \$5,786 ($\$5,250 + \536).

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 2
Level of Difficulty: Medium

51. Suvi, Inc. purchased two assets during the current year. It placed in service computer equipment (5-year property) on August 10 with a basis of \$20,000 and machinery (7-year property) on November 18 with a basis of \$10,000. Calculate the maximum depreciation expense, rounded to a whole number (ignoring section 179 or bonus expensing):

- A. \$857
- B. \$3,357
- C. \$5,429**
- D. \$6,000
- E. None of the above

The half-year convention applies. The calculations are $\$20,000 \times .2 = \$4,000$ and $\$10,000 \times .1429 = \$1,429$. The total is \$5,429 ($\$4,000 + \$1,429$).

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 2
Level of Difficulty: Medium

52. Wheeler LLC purchased two assets during the current year. It placed in service computer equipment (5-year property) on November 16 with a basis of \$15,000 and furniture (7-year property) on April 20 with a basis of \$11,000. Calculate the maximum depreciation expense, rounding to a whole number (ignoring section 179 or bonus expensing):

- A. \$1,285
- B. \$2,714**
- C. \$4,572
- D. \$5,200
- E. None of the above

The mid-quarter convention applies. The computer is 4th quarter property and the furniture is 2nd quarter property. The calculations are $\$15,000 \times .05 = \750 and $\$11,000 \times .1785 = \$1,964$. The total is \$2,714 ($\$750 + \$1,964$).

AACSB: Analytic, Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

53. Tasha LLC purchased furniture (7-year property) on April 20 with a basis of \$20,000 and used the mid-quarter convention. During the current year, which is the fourth year Tasha LLC owned the property, the property was disposed of on December 15. Calculate the maximum depreciation expense, rounding to a whole number:

- A. \$898
- B. \$2,095**
- C. \$2,461
- D. \$2,394
- E. None of the above

The mid-quarter convention applies. The property was placed in service during the 2nd quarter. The calculations are $\$20,000 \times .1197 = \$2,394$ and $\$2,394 \times 10.5/12 = \$2,095$ since the property was disposed of during the 4th quarter.

AACSB: Analytic, Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Hard

54. Anne LLC purchased computer equipment (5-year property) on August 29 with a basis of \$30,000 and used the half-year convention. During the current year, which is the fourth year Anne LLC owned the property, the property was disposed of on January 15. Calculate the maximum depreciation expense:

- A. \$432
- B. \$1,728**
- C. \$1,874
- D. \$3,456
- E. None of the above

The calculations are $\$30,000 \times .1152 = \$3,456 \times .5 = \$1,728$ since the property is considered to be owned for half the year in the year of disposition.

AACSB: Analytic, Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

55. Lenter LLC placed in service on April 29, 2009 machinery and equipment (7-year property) with a basis of \$400,000. Assume that Lenter has sufficient income to avoid any limitations. Calculate the maximum depreciation expense including section 179 expensing (but ignoring bonus expensing):

- A. \$57,160
- B. \$71,400
- C. \$171,154
- D. \$271,435**
- E. None of the above

The \$250,000 section 179 expense is not limited. The half year convention applies. The expense is \$271,435 which is depreciation of $\$150,000 \times .1429 = \$21,435$ plus \$250,000 of section 179 expense.

AACSB: Analytic, Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

56. Littman LLC placed in service on July 29, 2009 machinery and equipment (7-year property) with a basis of \$400,000. Littman's income for the current year before expensing was \$100,000. Calculate the maximum depreciation expense including section 179 expensing (but ignoring bonus expensing):

- A. 0.
- B. \$57,160.
- C. \$142,870.**
- D. \$271,435.
- E. None of the above.

The \$250,000 section 179 expense is limited to net income of \$100,000. The half year convention applies. The expense is \$142,870 which is depreciation of $\$300,000 \times .1429 = \$42,870$ plus \$100,000 of section 179 expense.

AACSB: Analytic, Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

57. Crouch LLC placed in service on May 19 machinery and equipment (7-year property) with a basis of \$900,000. Assume that Crouch has sufficient income to avoid any limitations. Calculate the maximum depreciation expense including section 179 expensing (but ignoring bonus expensing):

- A. \$128,610.
- B. \$156,894.
- C. \$257,175.**
- D. \$342,885.
- E. None of the above.

The \$250,000 section 179 expense is reduced to \$150,000 because of the property placed in service limitation ($\$900,000 - \$800,000$ threshold). The half year convention applies. The expense is \$257,175 which is depreciation of $\$750,000 \times .1429 = \$107,175$ plus \$150,000 of section 179 expense.

AACSB: Analytic, Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

58. Clay LLC placed in service machinery and equipment (7-year property) with a basis of \$1,000,000 on June 6, 2008. Assume that Clay has sufficient income to avoid any limitations. Calculate the maximum depreciation expense including section 179 expensing and bonus expensing, rounded to a whole number:

- A. \$142,900
- B. \$357,175
- C. \$592,878**
- D. \$785,725
- E. None of the above

The \$250,000 section 179 expense is reduced to \$50,000 because of the property placed in service limitation (\$1,000,000 - \$800,000 threshold). The half-year convention applies. The expense is 592,878 which is depreciation of $\$475,000 \times .1429 = \$67,878$ plus \$50,000 of section 179 expense, and \$475,000 of bonus depreciation.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 2
Level of Difficulty: Hard

59. Bonnie Jo purchased a computer (5-year property) for use in her sole proprietorship. The basis of the computer was \$2,400. Bonnie Jo used the computer in her business 60 percent of the time and used it for personal purposes the rest of the time during the first year. Calculate Bonnie Jo's depreciation expense during the first year assuming the sole proprietorship had a loss during the year:

- A. \$240
- B. \$288**
- C. \$480
- D. \$2,400
- E. None of the above

The asset's recovery period is 5 years and the half-year convention applies. The calculation is $\$2,400 \times .2 \times 60\% = \288 .

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 2
Level of Difficulty: Medium

60. Billie Bob purchased a computer (5-year property) for use in his sole proprietorship in the prior year. The basis of the computer was \$2,400. Billie Bob used the computer in his business 60 percent of the time during the first year. During the second year, Billie Bob used the computer 40 percent for business use. Calculate Billie Bob's depreciation expense during the second year assuming the sole proprietorship had a loss during the year:

- A. \$0
- B. \$48**
- C. \$192
- D. \$336
- E. None of the above

Because the listed property's business use drops below 50%, the straight-line method must be used and all prior years' excess depreciation must be recaptured. The asset's recovery period is 5 years and the half-year convention applies. The calculation for the current year's depreciation before adjusting for the prior year is $\$2,400 \times .2 \times 40\% = \192 . But he must recapture prior depreciation of \$144 ($\$2,400 \times .2 \times 60\% = \288 taken less \$144 (straight-line, $\frac{1}{2}$ year) that would have been taken. Therefore, the current year depreciation expense is $\$192 - \$144 = \$48$.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 2
Level of Difficulty: Hard

61. Potomac LLC purchased an automobile for \$30,000 on August 5th of 2008. What is Potomac's depreciation expense for 2008?

- A. \$2,960**
- B. \$4,287
- C. \$6,000
- D. \$30,000
- E. None of the above

A luxury auto's maximum depreciation in the first year for 2008 is \$2,960.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Easy

62. Arlington LLC purchased an automobile for \$40,000 on July 5th of 2008. What is Arlington's depreciation expense for 2008 if its business use percentage is 75 percent?

- A. \$2,220
- B. \$2,960
- C. \$6,000
- D. \$8,000
- E. None of the above

A luxury auto's maximum depreciation in the first year for 2008 is $\$2,960 \times 75\% = \$2,220$.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 2
Level of Difficulty: Medium

63. Poplock LLC purchased a warehouse and land during the current year for \$350,000. The purchase price was allocated as follows: \$275,000 to the building and \$75,000 to the land. The property was placed in service on August 12. Calculate Poplock's maximum depreciation for this first year, rounded to the nearest whole number:

- A. \$2,648
- B. \$3,371
- C. \$3,751
- D. \$4,774
- E. None of the above

The mid-month convention applies. Non-residential property has a 39-year recovery period. The depreciation is \$2,648 ($\$275,000 \times .963\%$).

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Easy

64. Tom Tom LLC purchased a rental house and land during the current year for \$150,000. The purchase price was allocated as follows: \$100,000 to the building and \$50,000 to the land. The property was placed in service on May 22. Calculate Tom Tom's maximum depreciation for this first year:

- A. \$1,605
- B. \$2,273**
- C. \$2,408
- D. \$3,410
- E. None of the above

The mid-month convention applies. Residential property has a 27.5-year recovery period. The depreciation is \$2,273 ($\$100,000 \times 2.273\%$).

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Easy

65. Simmons LLC purchased an office building and land several years ago for \$250,000. The purchase price was allocated as follows: \$200,000 to the building and \$50,000 to the land. The property was placed in service on October 2. If the property is disposed of on February 27 during the 10th year, calculate Simmons' maximum depreciation in the 10th year:

- A. \$641**
- B. \$909
- C. \$5,128
- D. \$7,346
- E. None of the above

The mid-month convention applies. Non-residential property has a 39-year recovery period. The depreciation is \$641 ($\$200,000 \times 2.564\% \times 1.5/12$).

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 2
Level of Difficulty: Medium

66. Assume that Bethany acquires a competitor's assets on March 31st. The purchase price was \$150,000. Of that amount, \$125,000 is allocated to tangible assets and \$25,000 is allocated to goodwill (a §197 intangible asset). What is Bethany's amortization expense for the current year, rounded to the nearest whole number?

- A. \$0
- B. \$1,250
- C. \$1,319
- D.** \$1,389
- E. None of the above

The full-month convention applies. Section 197 assets have a recovery period of 180 months. The amortization is \$1,389 $(\$25,000/180) \times 10$.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 3
Level of Difficulty: Medium

67. Assume that Brittany acquires a competitor's assets on September 30th of the prior year. The purchase price was \$350,000. Of that amount, \$300,000 is allocated to tangible assets and \$50,000 is allocated equally to two §197 intangible assets (goodwill and a 1-year non-compete agreement). Given, that the non-compete agreement expires on September 30th of year 2, what is Brittany's amortization expense for the second year, rounded to the nearest whole number?

- A. \$0
- B. \$1,667
- C. \$2,917
- D.** \$3,333
- E. None of the above

The full-month convention applies. If a section 197 asset is disposed of before it is fully recovered, the remaining basis is added to the remaining section 197 assets acquired at the same time. Section 197 assets have a recovery period of 180 months. The amortization is \$3,333 $(\$50,000/180) \times 12$. The result is as if the asset never expired.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 3
Level of Difficulty: Medium

68. Jasmine started a new business in the current year. She incurred \$10,000 of start-up costs. How much of the start-up costs can be immediately expensed for the year?

- A. \$0
- B. \$2,500
- C. \$5,000**
- D. \$10,000
- E. None of the above

\$5,000 of start-up expenses can be immediately expensed. The \$5,000 maximum phases out dollar for dollar if more than \$50,000 of start-up costs are incurred.

AACSB: Analytic, Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 3
Level of Difficulty: Easy

69. Racine started a new business in the current year. She incurred \$52,000 of start-up costs. If her business started on November 23rd of the current year, what is the total expense she may deduct with respect to the start-up costs for her initial year, rounded to the nearest whole number?

- A. \$2,555
- B. \$3,544**
- C. \$5,522
- D. \$52,000
- E. None of the above

\$5,000 of start-up expenses can be immediately expensed. The \$5,000 maximum phases out dollar for dollar if more than \$50,000 of start-up costs are incurred. Thus, the immediate expensing is \$3,000 ($\$5,000 - (\$52,000 - \$50,000)$). The amortization is \$544 ($\$49,000/180$) \times 2 months.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 3
Level of Difficulty: Medium

70. Daschle LLC completed some research and development during June of the current year. The related costs were \$60,000. If Daschle wants to capitalize and amortize the costs as quickly as possible, what is the total amortization expense Daschle may deduct during the current year?

- A. \$0
- B. \$6,500
- C. \$7,000**
- D. \$12,000
- E. None of the above

The amortization when capitalization is elected is \$7,000 ($\$60,000/60$) \times 7 months. The amortization period on a purchased patent is the asset's remaining useful life.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 3
Level of Difficulty: Easy

71. Jorge purchased a copyright for use in his business in the current year. The purchase occurred on July 15th and the purchase price was \$75,000. If the patent has a remaining life of 75 months, what is the total amortization expense Jorge may deduct during the current year?

- A. \$0
- B. \$5,500
- C. \$6,000**
- D. \$12,000
- E. None of the above

The amortization is \$6,000 ($\$75,000/75$) \times 6. The amortization period on a purchased patent is the asset's remaining useful life.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 3
Level of Difficulty: Easy

72. Geithner LLC patented a process it developed in the current year. The patent is expected to create benefits for Geithner over a 10 year period. The patent was issued on April 15th and the legal costs associated with the patent were \$43,000. In addition, Geithner had unamortized research expenditures of \$15,000 related to the process. What is the total amortization expense Geithner may deduct during the current year?

- A. \$2,417
- B. \$2,559**
- C. \$4,108
- D. \$4,350
- E. None of the above

The amortization is \$2,559 $(\$58,000/204) \times 9$ months. The amortization period is 17 years regardless of the asset's expected useful life.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 3
Level of Difficulty: Easy

73. Santa Fe purchased the rights to extract turquoise on a tract of land over a five-year period. Santa Fe paid \$300,000 for extraction rights. A geologist estimates that Santa Fe will recover 5,000 pounds of turquoise. During the current year, Santa Fe extracted 1,500 pounds of turquoise, which it sold for \$200,000. What is Santa Fe's cost depletion expense for the current year?

- A. \$60,000
- B. \$90,000**
- C. \$110,000
- D. \$300,000
- E. None of the above

The depletion expense is \$90,000 $(\$300,000/5,000) \times 1,500$.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 4
Level of Difficulty: Easy

74. Santa Fe purchased the rights to extract turquoise on a tract of land over a five-year period. Santa Fe paid \$300,000 for extraction rights. A geologist estimated that Santa Fe will recover 5,000 pounds of turquoise. During the past several years, 4,000 pounds were extracted. During the current year, Santa Fe extracted 1,500 pounds of turquoise, which it sold for \$250,000. What is Santa Fe's cost depletion expense for the current year?

- A.** \$60,000
- B. \$90,000
- C. \$190,000
- D. \$160,000
- E. None of the above

The depletion expense is \$60,000 ($\$300,000/5,000$) \times 1,000. Cost depletion is limited to the taxpayer's basis. As a result, even though 1,500 pounds were extracted, only 1,000 pounds can be expensed under cost depletion.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 4
Level of Difficulty: Easy

75. Lucky Strike Mine (LLC) purchased a silver deposit for \$1,500,000. It estimated it would extract 500,000 ounces of silver from the deposit. Lucky Strike mined the silver and sold it reporting gross receipts of \$1.8 million, \$2.5 million, and \$2 million for years 1 through 3, respectively. During years 1 - 3, Lucky Strike reported net income (loss) from the silver deposit activity in the amount of (\$100,000), \$400,000, and \$100,000, respectively. In years 1 - 3, Lucky Strike actually extracted 400,000 ounces of silver as follows:

| Ounces extracted per year | | |
|----------------------------------|---------------|---------------|
| <u>Year 1</u> | <u>Year 2</u> | <u>Year 3</u> |
| 50,000 | 150,000 | 100,000 |

What is Lucky Strike's depletion expense for year 2 if the applicable percentage depletion for silver is 15 percent?

- A. \$200,000
- B. \$375,000
- C. \$400,000
- D.** \$450,000
- E. None of the above

The depletion expense is \$450,000, the greater of cost or percentage depletion. Cost depletion is \$450,000 $(\$1,500,000/500,000) \times 150,000$. Percentage depletion is \$200,000; the lesser of the statutory percentage \$375,000 $(\$2,500,000 \times .15)$ or \$200,000 $[(\$400,000 \times 50\%) = 50 \text{ percent of net income}]$.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 4
Level of Difficulty: Medium

Essay Questions

76. Janey purchased machinery on April 8th of the current year. The relevant costs for the year are as follows: machinery for \$10,000, \$800 shipping, \$50 for delivery insurance, \$500 for installation, \$750 for sales tax, \$150 for the annual tune up, and \$200 of property taxes (an annual tax on business property). What is Janey's tax basis for the machinery?

\$12,100.

Feedback: An asset's basis consists of all of the costs to purchase, install, and place the asset in service. The annual tune up is a repair and the annual property tax is a general business expense.

AACSB: Reflective thinking, Analytic

AICPA: Critical thinking

Bloom's: Analysis

Learning Objective: 1

Level of Difficulty: Easy

77. Jaussi purchased a computer several years ago for \$2,200 and used it for personal purposes. On November 10th of the current year, when the fair market value of the computer was \$800, Jaussi converted it to business use. What is Jaussi's tax basis for the computer?

\$800.

Feedback: When personal property is converted to business use, the basis is the lesser of the cost basis of the property or the fair market value on the date of the conversion.

AACSB: Reflective thinking, Analytic

AICPA: Critical thinking

Bloom's: Analysis

Learning Objective: 1

Level of Difficulty: Easy

78. Flax, LLC purchased only one asset during 2008. It placed in service an automobile (5-year property) on January 16 with a basis of \$14,000. Calculate the maximum depreciation expense (ignoring section 179 or bonus expensing).

\$2,800.

Feedback: The asset's recovery period is 5 years and the half-year convention applies since less than 40 percent of the property was placed in service during the fourth quarter. The calculation is $\$14,000 \times .2 = \$2,800$.

AACSB: Reflective thinking, Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Easy

79. Roth, LLC purchased only one asset during the current year. It placed in service computer equipment (5-year property) on November 1st with a basis of \$42,500. Calculate the maximum depreciation expense (ignoring section 179 or bonus expensing).

\$2,125.

Feedback: The asset's recovery period is 5 years and the mid-quarter convention applies since more than 40 percent of the property was placed in service during the fourth quarter. The calculation is $\$42,500 \times .05 = \$2,125$.

AACSB: Reflective thinking, Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Easy

80. Eddie purchased only one asset during the current year. It placed in service furniture (7-year property) on May 1st with a basis of \$26,500. Calculate the maximum depreciation expense, rounded to the nearest whole number (ignoring section 179 or bonus expensing).

\$3,787.

Feedback: The asset's recovery period is 7 years and the half-year convention applies since less than 40 percent of the property was placed in service during the fourth quarter. The calculation is $\$26,500 \times .1429 = \$3,787$.

AACSB: Reflective thinking, Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Easy

81. Teddy purchased only one asset during the current year. It placed in service machinery (7-year property) on October 1st with a basis of \$76,500. Calculate the maximum depreciation expense, rounded to the nearest whole number (ignoring section 179 or bonus expensing).

\$2,731.

Feedback: The asset's recovery period is 7 years and the mid-quarter convention applies since more than 40 percent of the property was placed in service during the fourth quarter. The calculation is $\$76,500 \times .0357 = \$2,731$.

AACSB: Reflective thinking, Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Easy

82. Amit purchased two assets during the current year. Amit placed in service computer equipment (5-year property) on April 16th with a basis of \$5,000 and furniture (7-year property) on September 9th with a basis of \$20,000. Calculate the maximum depreciation expense (ignoring section 179 or bonus expensing):

\$3,858

Feedback: The half-year convention applies since less than 40 percent of the property was placed in service during the fourth quarter. The calculations are $\$5,000 \times .2 = \$1,000$ and $\$20,000 \times .1429 = \$2,858$. The total is \$3,858 ($\$1,000 + \$2,858$).

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 2
Level of Difficulty: Medium

83. Yasmin purchased two assets during the current year. Yasmin placed in service computer equipment (5-year property) on May 26th with a basis of \$10,000 and machinery (7-year property) on December 9th with a basis of \$10,000. Calculate the maximum depreciation expense (ignoring section 179 or bonus expensing):

\$2,857

Feedback: The mid-quarter convention applies since more than 40 percent of the property was placed in service during the fourth quarter. The calculations are $\$10,000 \times .25 = \$2,500$ and $\$10,000 \times .0357 = \357 . The total is \$2,857 ($\$2,500 + \357).

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 2
Level of Difficulty: Medium

84. Bonnie Jo had two assets during the current year. The first was machinery with an original basis of \$15,000, currently in the second year of depreciation, and under the half-year convention. This asset was disposed of on October 1st of the current year. The second was furniture with an original basis of \$24,000 placed in service during the first quarter, currently in the fourth year of depreciation, and under the mid-quarter convention. What is Bonnie Jo's depreciation expense for the current year, rounded to the nearest whole number?

\$5,023.

Feedback: The depreciation expense for the current year is \$5,023. The calculations are $\$15,000 \times .32 \times 1/2 \text{ year} = \$2,400$ and $\$24,000 \times .1093 = \$2,623$. The total is \$5,023 ($\$2,400 + \$2,623$).

AACSB: Reflective thinking, Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

85. Kristine sold two assets on March 20th of the current year. The first was machinery with an original basis of \$51,000, currently in the fourth year of depreciation, and under the half-year convention. The second was furniture with an original basis of \$16,000 placed in service during the fourth quarter, currently in the third year of depreciation, and under the mid-quarter convention. What is Kristine's depreciation expense for the current year, rounded to the nearest whole number?

\$3,579.

Feedback: The depreciation on those assets are $\$51,000 \times .1249 \times 1/2 \text{ year} = \$3,185$ and $\$16,000 \times .1968 \times 1.5/12 = \394 , the total is \$3,579 ($\$3,185 + \394).

AACSB: Reflective thinking, Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

86. Timothy purchased a new computer for his consulting practice on October 15th of the current year. The basis of the computer was \$4,000. During the Thanksgiving holiday, he decided the computer didn't meet his business needs and gave it to his college-aged son in another state. The computer was never used for business purposes again. Timothy had \$50,000 of taxable income before depreciation. What is Timothy's total cost recovery expense with respect to the computer during the current year?

\$0.

Feedback: No depreciation expense or section 179 expense may be taken on an asset which is acquired by and disposed off during the same taxable year.

AACSB: Reflective thinking, Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Easy

87. Olney LLC placed in service on July 19, 2009 machinery and equipment (7-year property) with a basis of \$600,000. Assume that Olney has sufficient income to avoid any limitations. Calculate the maximum depreciation expense including section 179 expensing, rounded to the nearest whole number (but ignoring bonus expensing).

\$300,015.

Feedback: The \$250,000 section 179 expense is not limited. The half year convention applies. The expense is \$300,015 which is depreciation of $\$350,000 \times .1429 = \$50,015$ plus \$250,000 of section 179 expense.

AACSB: Analytic, Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

88. Columbia LLC placed in service on October 9, 2009 machinery and equipment (7-year property) with a basis of \$950,000. Assume that Columbia has sufficient income to avoid any limitations. Calculate the maximum depreciation expense including section 179 expensing (but ignoring bonus expensing) for the year, rounded to the nearest whole number.

\$130,345.

Feedback: The \$250,000 section 179 expense is limited to \$100,000 because of the property placed in service limitation ($\$250,000 - (\$950,000 - \$800,000)$). The mid-quarter convention applies. The expense is \$130,345 which is depreciation of $\$850,000 \times .0357 = \$30,345$ plus \$100,000 of section 179 expense.

AACSB: Analytic, Reflective thinking
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

89. Northern LLC placed in service on September 6th machinery and equipment (7-year property) with a basis of \$900,000. Assume that Northern has sufficient income to avoid any limitations. Calculate the maximum depreciation expense including section 179 expensing and bonus expensing, rounded to the nearest whole number.

\$578,588

Feedback: The \$250,000 section 179 expense is reduced to \$150,000 because of the property placed in service limitation ($\$900,000 - \$800,000$ threshold). The half-year convention applies. The expense is \$578,588 which is depreciation of $\$375,000 \times .1429 = \$53,588$ plus \$150,000 of section 179 expense, and \$375,000 of bonus depreciation.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Hard

90. Assume that Reid has 2009 taxable income of \$150,000 before the §179 expense and acquired the following assets: he placed in service computer equipment (5-year property) on August 6th with a basis of \$100,000 and machinery (7-year property) on November 9th with a basis of \$100,000. Calculate the maximum depreciation expense including section 179 expensing (but not bonus expensing).

\$157,500

Feedback: The \$250,000 section 179 expense is reduced to \$150,000 because the expensing is limited to net income before the section 179 expense. The mid-quarter convention applies because more than 40 percent of the tangible personal property was placed in service during the fourth quarter. The expense is \$157,500 which is depreciation of $\$50,000 \times .15 = \$7,500$ plus \$150,000 of section 179 expense.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

91. Phyllis purchased \$8,000 of specialized audio equipment that she uses in her business regularly. Occasionally, she uses the equipment for personal use. During the first year, Phyllis used the equipment for business use 70 percent of the time; however, during the current (second) year the business use fell to 40 percent. Assume that the equipment is seven-year MACRS property and is under the half-year convention. Assume the ADS recovery period is 10 years. What is the depreciation allowance for the current year, rounded to the nearest whole number?

Phyllis must recapture \$160 this year.

Feedback: Because the business use fell below 50 percent for the listed property. As a result, the depreciation for all years must be recalculated under the straight-line method over the ADS recovery period. During the first year depreciation was \$800 ($\$8,000 \times .1429 \times .7$). Using the straight-line method over the ADS recovery period the depreciation for year 1 would be \$280 ($\$8,000/10 \text{ years} \times .7 \times \frac{1}{2} \text{ year}$). Depreciation for year 2 would be \$320 ($\$8,000/10 \text{ years} \times .4$). Because the actual depreciation taken in year 1 exceeds the sum of the depreciation for years 1 and 2 under the ADS method, Phyllis must actually recapture \$160 into income during the current year.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 2
Level of Difficulty: Hard

92. Alexandra purchased a \$35,000 automobile during 2008. The business use was 70 percent. What is the allowable depreciation for the current year?

\$2,072

Feedback: The maximum depreciation for a luxury automobile during 2008 is \$2,960. Because the business use was 70 percent, depreciation is \$2,072 ($\$2,960 \times .7$).

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Easy

93. During August of the prior year, Julio purchased an apartment building that he used as a rental property. The basis was \$1,400,000. Calculate the maximum depreciation expense during the current year.

\$50,904.

Feedback: The asset's recovery period is 27.5 years and the mid-month convention applies for real property. The calculation is $\$1,400,000 \times .03636 = \$50,904$.

AACSB: Reflective thinking, Analytic

AICPA: Critical thinking

Bloom's: Analysis

Learning Objective: 2

Level of Difficulty: Easy

94. During April of the current year, Ronen purchased a warehouse that he used for business purposes. The basis was \$1,600,000. Calculate the maximum depreciation expense during the current year.

\$29,104.

Feedback: The asset's recovery period is 39 years and the mid-month convention applies for real property. The calculation is $\$1,600,000 \times .01819 = \$29,104$.

AACSB: Reflective thinking, Analytic

AICPA: Critical thinking

Bloom's: Analysis

Learning Objective: 2

Level of Difficulty: Easy

95. An office building was purchased on December 9th several years ago for \$2,500,000. The purchase price was allocated as follows: building \$1,900,000, landscaping \$100,000, and land \$500,000. During the current year, the 10th year, the building was sold on March 10th. Calculate the maximum depreciation expense for the real property during the current year, rounded to the nearest whole number.

\$10,149.

Feedback: The asset's recovery period is 39 years and the mid-month convention applies for real property. The calculation is $\$1,900,000 \times .02564 \times (2.5/12) = \$10,149$. Depreciation is allowed for 2.5 months in the year of disposal. The land improvements are not considered to be real property. The land is non-depreciable.

AACSB: Reflective thinking, Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 2
Level of Difficulty: Medium

96. Boxer LLC has acquired various types of assets recently. Below is a list of assets acquired during 2008 and 2009:

| <u>Asset</u> | <u>Cost Basis</u> | <u>Convention</u> | <u>Date Place in Service</u> |
|--------------------|-------------------|-------------------|------------------------------|
| Machinery | 25,000 | Half year | January 24, 2008 |
| Warehouse | 800,000 | Mid month | August 1, 2008 |
| Furniture | 100,000 | | October 5, 2009 |
| Computer equipment | 65,000 | | October 10, 2009 |
| Office equipment | 34,000 | | September 28, 2009 |
| Automobile | 35,000 | | July 15, 2009 |
| Office building | 800,000 | | September 24, 2009 |

Boxer did not elect section 179 expense or bonus depreciation in 2008, but would like elect section 179 expense for 2009 (assume that taxable income is sufficient). Calculate Boxer's maximum depreciation expense for 2009, rounded to the nearest whole number (ignore bonus depreciation for 2009).

\$234,587.

Feedback: Section 179 allows expensing of all the 2009 tangible personal property (\$199,000 = \$100,000 + \$65,000 + \$34,000), with the exception of the automobile. The maximum depreciation for 2009 on luxury automobiles is \$2,960. The depreciation of the remaining assets is as follows: 2008 machinery ($\$25,000 \times .2449 = \$6,123$), 2008 Warehouse ($\$800,000 \times .02564 = \$20,512$), and the 2009 Office building ($\$800,000 \times .00749 = \$5,992$).

| <u>Asset</u> | <u>2009 Depreciation</u> |
|--------------------|--------------------------|
| Machinery | 6,123 |
| Warehouse | 20,512 |
| Furniture | 100,000 |
| Computer equipment | 65,000 |
| Office equipment | 34,000 |
| Automobile | 2,960 |
| Office building | <u>5,992</u> |
| Total | \$234,587 |

AACSB: Reflective thinking, Analytic
 AICPA: Critical thinking
 Bloom's: Analysis
 Learning Objective: 2
 Level of Difficulty: Hard

97. Assume that Yuri acquires a competitor's assets on May 1st. The purchase price was \$500,000. Of the amount, \$325,000 is allocated to tangible assets and \$175,000 is allocated to goodwill (a §197 intangible asset). What is Yuri's amortization expense for the current year, rounded to the nearest whole number?

\$7,778.

Feedback: The full-month convention applies. Section 197 assets have a recovery period of 180 months. The amortization is $\$7,778 = (\$175,000/180) \times 8$.

AACSB: Reflective thinking, Analytic

AICPA: Critical thinking

Bloom's: Analysis

Learning Objective: 2

Level of Difficulty: Hard

98. Assume that Cannon LLC acquires a competitor's assets on June 15th of a prior year. On May 30th of the second year, the customer list is sold for \$10,000. The purchase price was \$450,000. Of the amount, \$196,200 is allocated to tangible assets and \$253,800 is allocated to three §197 intangible assets: \$153,000 to goodwill, \$50,400 a customer list with an expected life of 8 years, and \$50,400 to a 3 year non-compete agreement. Please round your amortization amounts to the nearest whole number. Round your allocation percentage to the nearest whole percentage (e.g., .1234 as 12%)

- 1) What is Cannon's amortization expense for the second year?
- 2) What is the basis of the intangibles at the end of the second year?

Cannon's amortization expense for the second year is \$16,500. This is calculated as follows:

| | Goodwill | Covenant | Customer List | Total |
|--|-----------|----------|---------------|-----------------|
| Initial basis | \$153,000 | \$50,400 | \$50,400 | |
| Recovery Period, months | 180 | 180 | 180 | |
| Per month | \$850 | \$280 | \$280 | |
| Year 1, 7 months | \$5,950 | \$1,960 | \$1,960 | |
| Year 2, 5 months | \$4,250 | \$1,400 | \$1,400 | \$7,050 |
| Basis, May 30, Year 2 | \$142,800 | \$47,040 | \$47,040 | |
| Selling price | | | \$(10,000) | |
| Remaining basis | \$142,800 | \$47,040 | \$37,040 | |
| Reallocation prorata on \$189,840 (Goodwill and covenant) 75%, 25% | \$27,780 | \$9,260 | \$(37,040) | |
| Reallocated basis | \$170,580 | \$56,300 | \$0 | |
| Remaining months | 168 | 168 | | |
| Per month, rounded | \$1,015 | \$335 | | |
| June – Dec. (7 months) | \$7,105 | \$2,345 | | \$9,450 |
| 1) Total amortization, Year 2 | \$11,355 | \$3,745 | \$1,400 | \$16,500 |

- 2) The basis of the remaining assets is as follows:

| | Goodwill | Covenant |
|-----------------------------------|------------------|-----------------|
| Initial basis | \$153,000 | \$50,400 |
| Amortization Year 1, 7 months | (5,950) | (1,960) |
| Amortization Year 2, 5 months | (4,250) | (1,400) |
| Reallocated basis, May 30, Year 2 | 27,780 | 9,260 |
| Amortization Year 2, 7 months | (7,105) | (2,345) |
| Basis, end of Year 2 | \$163,475 | \$53,955 |

Chapter 02 - Property Acquisition and Cost Recovery

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 3
Level of Difficulty: Hard

99. Oksana started an LLC on November 2 of the current year. She incurred \$30,000 of start-up costs. How much of the start-up costs can be immediately expensed for the year? How much amortization may Oksana deduct in the first year?

\$5,000 of start-up expenses can be immediately expensed and \$278 ($\$25,000/180$) \times 2 months of amortization may be deducted.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 3
Level of Difficulty: Medium

100. Putin Corporation began business on September 23rd of the current year. It incurred \$40,000 of start-up costs and \$60,000 of organizational expenditures.

1) How much may be immediately expensed for the year?
2) How much amortization may be deducted in the first year, rounded to the nearest whole number?

1) \$5,000 of start-up expenses can be immediately expensed. The immediate expensing of the organizational costs is phased out because the expenses exceed the \$55,000 threshold.
2) $(\$35,000/180) \times 4$ months = \$778 of the start-up costs may be amortized and $(\$60,000/180) \times 4$ months = \$1,333 of the organizational expenditures may be amortized.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 3
Level of Difficulty: Medium

101. Paulsen incurred \$55,000 of research and experimental expenses and began amortizing them over 60 months during June of year 1. During May of year 3, Paulsen received a patent based upon the research being amortized. \$36,000 of legal expenses for the patent was incurred.

- 1) What is the basis of the patent, rounding amortization for each year to the nearest whole number?
- 2) What is the amortization expense with respect to the patent during the year it was issued, rounded to the nearest whole number?

1) The basis of the patent is \$69,000 (\$36,000 of legal costs and \$33,000 of unamortized research expenses). The research expense is $\$55,000/60 \text{ months} = \916.67 . Year 1 is \$6,417 for 7 months; year 2 is a full year of \$11,000, and 5 months in year 3 is \$4,583. Total research expensed is \$22,000 and remaining unamortized expense to add to patent capitalization is \$33,000.

2) The amortization is $\$2,368 = (\$69,000/204 \text{ months}) \times 7 \text{ months in year 3}$.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 3
Level of Difficulty: Hard

102. Sequoia purchased the rights to cut timber on several tracts of land over a fifteen year period. It paid \$500,000 for cutting rights. A timber engineer estimates that 500,000 board feet of timber will be cut. During the current year, Sequoia cut 45,000 board feet of timber, which it sold for \$900,000. What is Sequoia's cost depletion expense for the current year?

The depletion expense is $\$45,000 (\$500,000/500,000) \times 45,000$.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Analysis
Learning Objective: 4
Level of Difficulty: Easy

103. PC Mine purchased a platinum deposit for \$3,500,000. It estimated it would extract 17,000 ounces of platinum from the deposit. PC mined the platinum and sold it reporting gross receipts of \$500,000 and \$8 million for years 1 and 2, respectively. During years 1 and 2, PC reported net income (loss) from the platinum deposit activity in the amount of (\$100,000) and \$3,800,000, respectively. In years 1 and 2, PC actually extracted 2,000 and 8,000 ounces of platinum. What is PC's depletion expense for years 1 and 2 if the applicable percentage depletion for platinum is 22 percent, rounded to the nearest whole number?

PC has cost depletion expense of \$411,765 ($\$3,500,000/17,000 \times 2,000$) in year 1. Because PC has a loss in year 1, there is no percentage depletion. PC has percentage depletion of \$1,760,000 in year 2: the lesser of \$1,760,000 ($\$8 \text{ million} \times 22 \text{ percent}$) or \$1,900,000 ($\$3.8 \text{ million} \times 50 \text{ percent}$). Cost depletion was \$1,647,059 ($\$3,500,000/17,000 \times 8,000$) and is less than percentage depletion.

AACSB: Analytic
AICPA: Critical thinking
Bloom's: Application, Analysis
Learning Objective: 4
Level of Difficulty: Medium