

REG Study Sheet

Taxation & Business Law

50 Essential Topics for CPA Exam Success

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INDIVIDUAL TAXATION - BASICS

Filing Status (Best to Worst Tax Rates)

1. **Married Filing Jointly (MFJ)** - Best rates, highest standard deduction
2. **Qualifying Surviving Spouse (QSS)** - Same as MFJ; spouse died in prior 2 years, has dependent child
3. **Head of Household (HOH)** - Unmarried, pays >50% of home costs, has qualifying person
4. **Single** - Unmarried and doesn't qualify for HOH
5. **Married Filing Separately (MFS)** - Worst rates, lose many credits

Individual Tax Formula

Gross Income

- Above-the-line deductions (FOR AGI)

= Adjusted Gross Income (AGI)

- Standard Deduction OR Itemized Deductions

- Qualified Business Income (QBI) Deduction

= Taxable Income

× Tax Rates

= Tax Liability

- Credits

= Tax Due or Refund

Gross Income - What's Included

- Wages, salaries, tips, bonuses
- Interest and dividends (qualified dividends taxed at capital gains rates)
- Business income (Schedule C)
- Capital gains
- Rental income
- Alimony received (for divorces finalized BEFORE 2019)
- Unemployment compensation
- Gambling winnings

Gross Income - What's EXCLUDED

- Municipal bond interest (tax-exempt)
- Life insurance proceeds (death benefit)
- Gifts and inheritances received
- Workers' compensation
- Child support received
- Qualified scholarships (tuition and fees only)
- Employer-provided health insurance

DEDUCTIONS FOR & FROM AGI

Above-the-Line Deductions (FOR AGI)

These reduce AGI and are available even if you take the standard deduction:

- **Educator expenses:** Up to \$300 for qualified K-12 teachers
- **HSA contributions:** \$4,150 self-only / \$8,300 family (2024)
- **Self-employed health insurance:** 100% of premiums deductible
- **Self-employment tax:** Deduct 50% of SE tax
- **IRA contributions:** Up to \$7,000 (\$8,000 if 50+)
- **Student loan interest:** Up to \$2,500 (phases out at higher incomes)
- **Alimony paid:** For divorces finalized BEFORE 2019
- **Moving expenses:** Only for active-duty military

Standard Deduction (2024)

- Single / MFS: \$14,600
- MFJ / QSS: \$29,200
- HOH: \$21,900
- Additional \$1,550 for blind or 65+ (\$1,950 if unmarried)

Itemized Deductions (FROM AGI)

Medical Expenses:

- Deductible: Amount exceeding 7.5% of AGI
- Includes: Doctor visits, prescriptions, insurance premiums, medical equipment

State and Local Taxes (SALT):

- CAPPED at \$10,000 total (\$5,000 if MFS)
- Includes: State income tax OR sales tax (choose one) + property taxes

Mortgage Interest:

- Acquisition debt up to \$750,000 (\$1M if grandfathered)
- Home equity loan interest only if used for home improvements

Charitable Contributions:

- Cash to public charities: Up to 60% of AGI
- Appreciated property: Up to 30% of AGI (at FMV)
- Must have documentation; \$250+ requires written acknowledgment

Casualty Losses:

- Only federally declared disaster areas
- Reduced by \$100 per event AND 10% of AGI

PROPERTY TRANSACTIONS

Basis Rules

Purchased Property:

Basis = Purchase Price + Closing Costs + Capital Improvements

Gift Property:

- For GAINS: Use donor's carryover basis (plus portion of gift tax paid)
- For LOSSES: Use LOWER of donor's basis or FMV at gift date
- If sold between both bases, NO gain or loss ('dead zone')

Inherited Property:

- Stepped-up basis to FMV at date of death
- Holding period is automatically LONG-TERM

Tip: Inherited property gets stepped-up basis, eliminating all pre-death appreciation from taxation.

Capital Gains and Losses

Short-term (held ≤1 year): Taxed at ordinary income rates (up to 37%)

Long-term (held >1 year): Preferential rates:

- 0% rate if taxable income ≤ \$47,025 (single) / \$94,050 (MFJ)
- 15% rate for most taxpayers
- 20% rate for highest earners
- 28% rate for collectibles (art, coins, etc.)
- 25% rate for unrecaptured Section 1250 gain (depreciation recapture on real estate)

Netting Process:

- Net ST gains and losses together
- Net LT gains and losses together
- Then net the results
- Net capital LOSS deduction limited to \$3,000/year (\$1,500 MFS)
- Excess losses carry forward indefinitely

Section 1031 Like-Kind Exchange

Allows deferral of gain when exchanging qualifying real property:

- Must be real property held for business or investment (NOT inventory, NOT personal use)
- Personal property NO LONGER qualifies (after 2017)

Gain Recognized = LESSER of (Realized Gain, Boot Received)

New Basis = Old Basis - Boot Received + Gain Recognized

- **Boot** = Cash or non-like-kind property received
- Timelines: 45 days to identify replacement, 180 days to close

Tip: Mortgage relief is treated as boot received (increases recognized gain).

PROPERTY TRANSACTIONS (CONTINUED)

Section 121 - Sale of Principal Residence

Exclusion from gain on sale of principal residence:

- Single: Up to \$250,000 excluded
- MFJ: Up to \$500,000 excluded

Requirements:

- Owned the home for at least 2 of the last 5 years
- Used as principal residence for at least 2 of the last 5 years
- Haven't used the exclusion in the past 2 years
- Partial exclusion available if sale due to health, employment, or unforeseen circumstances

Section 1033 - Involuntary Conversion

Allows deferral when property is destroyed, condemned, or stolen and proceeds are reinvested:

- Must reinvest in similar property within replacement period
- Replacement period: 2 years (3 years for condemned real estate)

Gain Recognized = Proceeds NOT Reinvested

- If reinvest ALL proceeds, defer ALL gain
- Paying off mortgage does NOT count as reinvestment

Installment Sales

Allows recognition of gain as payments are received:

Gross Profit % = Gross Profit ÷ Contract Price

Gain Recognized = Payment Received × Gross Profit %

- Cannot use for inventory or dealer property
- Cannot use for losses (recognize entirely in year of sale)
- Interest must be charged (or IRS imputes it)

Depreciation Recapture

Section 1245 (Personal Property):

- ALL depreciation recaptured as ordinary income
- Applies to machinery, equipment, vehicles

Section 1250 (Real Property):

- Only EXCESS depreciation (over straight-line) recaptured as ordinary income
- Straight-line depreciation taxed at max 25% rate (unrecaptured 1250 gain)
- Remainder is Section 1231 gain (long-term capital gain)

BUSINESS ENTITIES

Entity Comparison

C Corporation:

- Taxed at entity level (flat 21% rate)
- Dividends taxed again to shareholders (double taxation)
- Unlimited shareholders, any type
- Can choose any fiscal year end

S Corporation:

- Pass-through entity (no entity-level tax)
- Income/loss passes to shareholders via K-1
- Shareholders pay SE tax only on wages, NOT distributions
- Limited to 100 shareholders (family members count as one)

Partnership:

- Pass-through entity
- Income/loss passes to partners via K-1
- General partners pay SE tax on their share
- Basis includes share of partnership liabilities

Sole Proprietorship:

- Reported on Schedule C
- Owner pays SE tax on net profit

S Corporation Requirements

To be eligible for S election:

- Domestic corporation
- ≤100 shareholders (family members treated as one)
- Only individuals, estates, certain trusts can be shareholders
- NO partnerships, corporations, or nonresident aliens
- Only ONE class of stock (voting differences OK)
- Must use calendar year (unless business purpose for fiscal)

Tip: If S requirements are violated, the election terminates and the entity becomes a C corp.

Partnership and S Corp Basis

Partnership Basis:

Initial Basis = Cash + Adjusted Basis of Property + Share of Liabilities

- INCREASES: Additional contributions, share of income, share of liabilities
- DECREASES: Distributions, share of losses, decrease in liabilities

S Corp Stock Basis:

- Same as partnership EXCEPT:
- Does NOT include corporate-level debt (only direct shareholder loans)
- Separately stated items affect basis differently

LOSS LIMITATIONS

Order of Loss Limitations

Losses must clear these hurdles IN ORDER:

1. BASIS LIMITATION:

- Cannot deduct losses exceeding your basis in the entity
- Excess losses suspended and carried forward indefinitely

2. AT-RISK LIMITATION:

- Cannot deduct more than your 'at-risk' amount
- At-risk = cash invested + recourse debt + certain qualified nonrecourse debt
- Does NOT include nonrecourse debt (except qualified real estate)

3. PASSIVE ACTIVITY LOSS LIMITATION:

- Passive losses only offset passive income
- Excess passive losses suspended until you have passive income or dispose of the activity

4. EXCESS BUSINESS LOSS LIMITATION:

- Cannot deduct excess business losses above threshold
- 2024 limit: \$305,000 single / \$610,000 MFJ
- Excess becomes Net Operating Loss carryforward

Passive Activity Rules

Passive Activities:

- Trade or business in which taxpayer does NOT materially participate
- ALL rental activities are presumed passive (with exceptions)

\$25,000 Rental Real Estate Exception:

- Can deduct up to \$25,000 of rental losses against active income
- Must actively participate (make management decisions)
- Phases out between \$100,000-\$150,000 AGI (50 cents per dollar)

Real Estate Professional Exception:

- 750+ hours in real property trades or businesses, AND
- >50% of personal services in real property activities
- Rental activities treated as ACTIVE (not passive)

CORPORATE TAXATION

C Corporation Tax Rate

Flat 21% corporate tax rate

Dividends Received Deduction (DRD)

When a corporation receives dividends from another corporation:

- <20% ownership: 50% DRD

- 20-79% ownership: 65% DRD
- $\geq 80\%$ ownership: 100% DRD
- DRD may be limited to percentage of taxable income

TAX DEPRECIATION

MACRS Recovery Periods

- **3-year:** Tractor units, rent-to-own property
- **5-year:** Automobiles, computers, office equipment, appliances
- **7-year:** Office furniture, fixtures, most machinery
- **15-year:** Land improvements (landscaping, sidewalks, fences)
- **27.5-year:** Residential rental property (straight-line, mid-month)
- **39-year:** Nonresidential real property (straight-line, mid-month)

Depreciation Conventions

Half-year convention: Most personal property

- Treated as placed in service at midpoint of year
- First year: Half of normal depreciation

Mid-quarter convention: If >40% of property placed in service in Q4

- Each quarter gets depreciation based on mid-quarter

Mid-month convention: Real property

- Depreciation starts at mid-point of month placed in service

Section 179 Expensing

- Immediate expense election up to \$1,220,000 (2024)
- Phase-out begins at \$3,050,000 of property placed in service
- Cannot create or increase a loss (limited to taxable income)
- Applies to most tangible personal property

Bonus Depreciation

- 2024: 60% first-year bonus (phases down 20% per year)
- Applies to new AND used property
- NO taxable income limitation (can create loss)
- Can elect out class-by-class

TAX CREDITS

Key Individual Tax Credits

Child Tax Credit: \$2,000 per qualifying child under 17

- Partially refundable (up to \$1,700)
- Phases out at higher incomes

Child & Dependent Care Credit:

- Up to 35% of \$3,000 (1 child) or \$6,000 (2+ children)
- Nonrefundable

Earned Income Credit (EIC):

- REFUNDABLE credit for low-income workers
- Amount depends on earned income and number of children
- Investment income must be \leq \$11,000

Education Credits:

- American Opportunity: \$2,500 max, 40% refundable, first 4 years only
- Lifetime Learning: \$2,000 max, nonrefundable, any post-secondary

Tip: Credits reduce TAX directly; deductions only reduce TAXABLE INCOME.

PROFESSIONAL RESPONSIBILITIES

Circular 230 - Practice Before the IRS

Governs tax practitioners (CPAs, attorneys, enrolled agents):

Duties:

- Exercise due diligence in preparing and filing returns
- Advise clients of penalties for noncompliance
- Return client records promptly upon request
- Not charge unconscionable fees

Prohibited Conduct:

- Contingent fees for preparing original tax returns
- Providing false or misleading information
- Representing conflicting interests without consent

Tax Return Positions:

- Must have reasonable basis for positions taken
- Disclosed positions: Reasonable basis required
- Undisclosed positions: Substantial authority required

Tax Preparer Penalties

Unreasonable Position:

- Greater of \$1,000 or 50% of fee

Willful or Reckless Conduct:

- Greater of \$5,000 or 75% of fee

Other Penalties:

- Failure to sign return: \$50
- Failure to furnish copy to taxpayer: \$50
- Failure to retain copy: \$50
- Endorsing client's refund check: \$560

Taxpayer Penalties

- **Failure to file:** 5% per month (max 25%)
- **Failure to pay:** 0.5% per month (max 25%)
- **Negligence:** 20% of underpayment
- **Substantial understatement:** 20% (understatement >\$5,000 or 10% of tax)
- **Fraud:** 75% of underpayment

BUSINESS LAW

Contract Formation

Valid contract requires:

- **Offer:** Definite terms, intent to be bound
- **Acceptance:** Unequivocal assent to offer terms
- **Consideration:** Bargained-for exchange of value
- **Capacity:** Legal ability to contract (age, mental competence)
- **Legality:** Legal purpose

UCC Article 2 vs. Common Law

Common Law: Services, real estate, employment

- Mirror image rule for acceptance
- Modifications require new consideration

UCC Article 2: Sale of GOODS

- Battle of the forms - additional terms may be included
- Modifications need only good faith (no consideration required)
- Merchant rules apply between merchants

Statute of Frauds

Requires WRITTEN contract for:

- Sale of goods \geq \$500 (UCC)
- Real estate transactions
- Contracts that cannot be performed within one year
- Promises to pay another's debt (suretyship)
- Contracts in consideration of marriage

Agency Law

Principal-Agent Liability:

- Disclosed principal: Principal is liable, agent is not
- Partially disclosed: Both may be liable
- Undisclosed: Agent is liable (principal may be too once revealed)

Agent's Authority:

- Express: Explicitly granted
- Implied: Reasonably necessary to carry out express authority
- Apparent: Third party reasonably believes agent has authority

Bankruptcy Priority of Claims

1. Secured creditors (to extent of collateral)
2. Domestic support obligations (alimony, child support)
3. Administrative expenses (trustee fees, legal fees)
4. Gap claims (involuntary bankruptcy)
5. Employee wages (up to \$15,150 per employee, within 180 days)

6. Employee benefit plans
7. Consumer deposits (up to \$3,350)
8. Tax claims
9. General unsecured creditors
10. Equity holders (shareholders - last to receive anything)