

REG Complete Study Guide, Part 2

Olivia Anderson · True North Accounting & Business Solutions · Study notes for educational use. Always confirm details against the current AICPA Blueprints and authoritative standards.

Taxation and Regulation: the rest of Area II, Business Law, and Area III, Federal Taxation of Property Transactions (5–15%).

Debtor-Creditor Relationships

Suretyship and Guaranty

A **surety** promises to answer for another's debt and is **primarily** liable with the debtor: the creditor can go straight to the surety. A **guarantor of collection** is liable only after the creditor tries to collect from the debtor.

A suretyship promise must be in writing under the Statute of Frauds, unless the surety's **main purpose** is its own benefit.

The surety is discharged or has a defense when:

- The debt is paid or validly tendered
- The creditor releases the debtor without the surety's consent, unless the creditor reserves rights against the surety
- The contract is materially modified without the surety's consent
- The creditor releases or impairs collateral, to the extent of the impairment
- The surety was induced by fraud or duress by the creditor
- The debtor has a defense such as fraud, duress, failure of consideration or breach by the creditor

The surety is not discharged by: the debtor's incapacity, the debtor's bankruptcy, the creditor's failure to sue the debtor first or to give notice of default, or the statute of limitations running on the debtor's obligation.

The surety's rights

- **Exoneration:** compel the debtor to pay before the surety does.
- **Reimbursement:** recover from the debtor what the surety paid.
- **Subrogation:** after paying, step into the creditor's shoes, including rights in collateral.
- **Contribution:** recover from co-sureties their proportionate share.

Co-surety example: A guarantees \$60,000 and B guarantees \$40,000 of a \$100,000 debt. If A pays the entire \$100,000, A can recover \$40,000 from B.

Secured Transactions (UCC Article 9)

Attachment makes a security interest enforceable against the debtor when:

1. Value has been given,
2. The debtor has rights in the collateral, and
3. There's an authenticated security agreement describing the collateral, or the creditor has possession or control.

Perfection protects the security interest against third parties:

- **Filing** a UCC-1 financing statement, the most common method
- **Possession** of goods, instruments or money
- **Control** of deposit accounts and investment property
- **Automatic** perfection for a **purchase money security interest (PMSI) in consumer goods** and for certain small assignments of accounts

Where to file: for a registered organization such as a corporation or LLC, in its state of organization. For an individual, in the state of principal residence. Fixture filings go where the real property is located.

PRIORITIES

- The general rule is the first to file or perfect.
- **PMSI in inventory:** has priority if perfected before the debtor receives the inventory and the holders of earlier security interests receive notice.
- **PMSI in equipment:** has priority if perfected within 20 days after the debtor receives the collateral.
- **A buyer in the ordinary course of business** takes free of a security interest created by the seller, even if it's perfected and the buyer knows of it.
- An **unperfected** security interest loses to a lien creditor, such as a bankruptcy trustee, who arises before perfection.

DEFAULT

The secured party may repossess the collateral without judicial process if it does so without a breach of the peace, may sue on the debt, and may sell the collateral in a commercially reasonable manner. The debtor gets any surplus and is liable for any deficiency.

Bankruptcy

CHAPTER	PURPOSE	WHO MAY USE IT
7	Liquidation: a trustee sells nonexempt assets and distributes the proceeds	Individuals and businesses
11	Reorganization under a court-approved plan	Mainly businesses
13	Adjustment of debts through a three- to five-year repayment plan	Individuals with regular income, within debt limits

Voluntary petitions can be filed under Chapters 7, 11 or 13. **Involuntary petitions** are allowed only under Chapters 7 and 11, not against farmers or nonprofits.

- With **12 or more** creditors, at least **3** must join.
- With **fewer than 12**, **one** creditor may file.
- The petitioners' unsecured, undisputed claims must total at least a threshold that is adjusted periodically for inflation.

The automatic stay halts most collection activity when the petition is filed. Exceptions include criminal proceedings, collection of domestic support obligations and certain tax audits and assessments.

The bankruptcy estate includes the debtor's property at filing, plus inheritances, life insurance proceeds and property settlements the debtor becomes entitled to within 180 days after filing. In Chapter 13, postpetition earnings are also included.

Exemptions: individual debtors may keep exempt property under federal exemptions or, if the state requires, state exemptions. Examples include a homestead amount, a motor vehicle, household goods, tools of the trade and retirement funds. The dollar amounts are adjusted periodically.

THE TRUSTEE'S AVOIDANCE POWERS

- **Preferential transfers:** a transfer to a creditor for an existing debt, made while the debtor was insolvent, within **90 days** before filing, or **one year** for insiders, that gives the creditor more than it would get in a Chapter 7 liquidation. Exceptions include contemporaneous exchanges for new value, payments in the ordinary course of business and certain perfected purchase money security interests.
- **Fraudulent transfers:** made within **two years** before filing with intent to hinder, delay or defraud creditors, or for less than reasonably equivalent value while insolvent.

DISTRIBUTION OF THE ESTATE

1. **Secured creditors** are paid first from their collateral. Any unpaid balance becomes an unsecured claim.
2. **Priority unsecured claims**, in order:
 1. Domestic support obligations, such as alimony and child support
 2. Administrative expenses of the bankruptcy
 3. "Gap" claims arising in an involuntary case before the order for relief

4. Wages, salaries and commissions earned within 180 days before filing, up to a capped amount per person
 5. Contributions to employee benefit plans, up to a capped amount
 6. Certain claims of farmers and fishermen
 7. Consumer deposits, up to a capped amount
 8. Certain taxes
3. **General unsecured creditors**, pro rata
 4. **Equity holders**

DISCHARGE

Debts that are not discharged include most recent taxes, domestic support obligations, student loans (absent undue hardship), debts from fraud or false financial statements, willful and malicious injuries, injuries caused by driving while intoxicated, fines and penalties owed to governments, and debts not listed in the petition.

A Chapter 7 discharge can be denied for concealing or destroying property, making false oaths, failing to keep or produce financial records, or receiving a Chapter 7 discharge within the previous eight years.

Federal Laws and Regulations

Employment Taxes

TAX	EMPLOYER	EMPLOYEE
Social Security (OASDI)	6.2% of wages up to the annual wage base (\$184,500 for 2026)	6.2%, withheld
Medicare	1.45% of all wages	1.45% of all wages, plus a 0.9% Additional Medicare Tax on wages over \$200,000, with no employer match
FUTA (federal unemployment)	6.0% of the first \$7,000 of each employee's wages, reduced by a credit of up to 5.4% for state unemployment taxes paid, for a net rate as low as 0.6%	None

Employers must withhold income tax and the employee share of FICA, deposit taxes on time and file quarterly returns (Form 941) and an annual FUTA return (Form 940). A responsible person who willfully fails to remit withheld taxes can be personally liable for the **trust fund recovery penalty**, equal to 100% of the unpaid trust fund taxes.

Worker Classification

The IRS's common-law test asks whether the business has the **right to control** what work is done and **how** it is done. The evidence falls into three groups:

- **Behavioral control:** instructions, training and evaluation methods
- **Financial control:** investment in equipment, unreimbursed expenses, opportunity for profit or loss and method of payment
- **Relationship:** written contracts, benefits, permanence and whether the work is a key part of the business

Misclassifying employees as independent contractors can result in liability for unpaid employment taxes, penalties and interest.

Qualified Health Plans (the Affordable Care Act)

- **Employer shared responsibility: applicable large employers,** with 50 or more full-time employees including full-time equivalents, may owe a payment if they don't offer affordable, minimum-value coverage to substantially all full-time employees, and at least one employee receives a premium tax credit. They report coverage on Forms 1094-C and 1095-C.
- **Premium tax credit:** a refundable credit that helps eligible individuals buy coverage through a Marketplace. Advance payments are reconciled on the individual's return (Form 8962).
- **COBRA:** employers with 20 or more employees must offer qualifying former employees and dependents continued group health coverage, generally for up to 18 months, at the employee's expense.

Anti-Bribery: the Foreign Corrupt Practices Act

- **Anti-bribery provisions:** prohibit issuers, domestic concerns and others acting in the U.S. from corruptly offering or paying anything of value to a **foreign official** to obtain or keep business. Facilitating payments for routine government actions are a narrow exception.
- **Accounting provisions:** require SEC issuers to keep accurate books and records and maintain adequate internal accounting controls.

Violations can bring criminal fines and imprisonment for individuals, and large fines for companies.

Business Structures

Sole Proprietorship

One owner, no separate legal entity and unlimited personal liability. Business income is reported on Schedule C.

General Partnership

- **Formation:** two or more persons carrying on a business for profit as co-owners. No filing is required.
- **Management:** equal rights. Ordinary matters are decided by majority, and extraordinary matters require unanimous consent.

- **Profits and losses:** shared equally unless agreed otherwise. Losses are shared like profits.
- **Liability:** partners are jointly and severally liable for partnership obligations. A new partner isn't personally liable for debts incurred before joining, although the partner's capital is at risk. A dissociated partner remains liable for debts incurred while a partner.
- **Fiduciary duties:** loyalty (no competing, self-dealing or usurping opportunities) and care. Partners must account for profits.
- **Dissolution and winding up:** pay creditors, including partners who are creditors, then settle partners' capital accounts.

Limited Partnership

- Requires a certificate filed with the state and at least one general partner and one limited partner.
- General partners manage the business and have unlimited liability.
- Limited partners have liability limited to their investment. Under the current uniform act, they don't lose that protection merely by participating in management.

Limited Liability Partnership

A general partnership that files with the state. Partners are generally not personally liable for other partners' misconduct or the partnership's obligations, but remain liable for their own negligence. LLPs are common for professional firms.

Limited Liability Company

- Formed by filing articles of organization.
- Members have limited liability, subject to veil piercing for fraud or misuse.
- It may be **member-managed** or **manager-managed**.
- For taxes, a multimember LLC is a partnership and a single-member LLC is disregarded, unless it elects to be taxed as a corporation.

Corporations

Formation: file articles of incorporation. **Promoters** are personally liable on preincorporation contracts unless a **novation** releases them. The corporation is liable only if it adopts the contract.

Characteristics: a separate legal entity with perpetual existence, limited liability and free transferability of shares. A C corporation faces double taxation.

Shareholders elect directors and vote on fundamental changes. They have rights to inspect books and records for a proper purpose, to receive declared dividends, to sue derivatively on the corporation's behalf and, if the articles provide, preemptive rights.

Directors set policy, appoint officers and declare dividends. They owe duties of **care** and **loyalty**. The **business judgment rule** protects informed, good-faith decisions made without a conflict of interest. Directors who approve illegal dividends, those that would make the corporation insolvent, can be personally liable.

Officers run day-to-day operations and owe the same fiduciary duties.

Piercing the corporate veil: courts may hold shareholders personally liable for fraud, gross undercapitalization, commingling of funds, ignoring formalities or using the corporation as an alter ego.

Fundamental changes, such as mergers, sales of substantially all assets and dissolution, require board approval and a shareholder vote. Dissenting shareholders have **appraisal rights** to be paid the fair value of their shares.

Area III: Federal Taxation of Property Transactions

The REG blueprint focuses this area on **basis** and **cost recovery**. Gains, losses, Section 1231, recapture and like-kind exchanges are tested mainly in **TCP**, but they appear here because REG questions often rely on them.

Capital Assets and Holding Periods

Capital assets are all property except:

- Inventory and property held for sale to customers
- Accounts and notes receivable from the business
- Depreciable property and real property used in a trade or business. These are Section 1231 property when held more than one year.
- Copyrights and artistic works in the hands of their creator
- Certain U.S. government publications

Examples of capital assets: stocks, bonds, investment property, a personal residence and a personal car.

Holding period: more than one year is long-term. The period starts the day after acquisition.

- Inherited property is always long-term.
- Gifted property takes the donor's holding period when the donor's basis is used.
- Property received in a nontaxable exchange takes the holding period of the property given up, if it was a capital or Section 1231 asset.

Basis

Cost basis includes the purchase price, sales tax, freight, installation and title costs.

Property bought from an employer at a bargain: basis is the price paid plus the amount included in income.

GIFTS

- **Gain property** (fair value at least equal to the donor's basis): the donee takes the donor's basis.
- **Loss property** (fair value below the donor's basis): the **double basis rule** applies.
 - Sold at a gain: use the donor's basis.
 - Sold at a loss: use the fair value at the date of the gift.
 - Sold between the two amounts: no gain or loss.

Example: the donor's basis is \$10,000 and the value at the gift date is \$7,000. Sold for \$11,000, the gain is \$1,000. Sold for \$6,000, the loss is \$1,000. Sold for \$8,000, there's no gain or loss.

OTHER RULES

- **Inherited property:** fair market value at the date of death, or the alternate valuation date six months later if the executor elects it.
- **Transfers between spouses, or former spouses incident to divorce:** no gain or loss, and the recipient takes a carryover basis.
- **Personal-use property converted to business use:** for depreciation and loss purposes, basis is the lower of adjusted basis or fair value at conversion.

Adjusted basis = original basis + capital improvements and assessments – depreciation, Section 179 and bonus deductions, and deducted casualty losses. Repairs that maintain property are deducted, not capitalized.

Cost Recovery

MACRS DEPRECIATION

Property must be used in a trade or business or held to produce income and must wear out. Land and inventory are never depreciated.

RECOVERY PERIOD	EXAMPLES	METHOD
3-year	Certain tractor units, some horses	200% declining balance
5-year	Cars, light trucks, computers, office equipment	200% declining balance
7-year	Office furniture and fixtures, most machinery	200% declining balance
27.5-year	Residential rental property	Straight-line
39-year	Nonresidential real property	Straight-line

Conventions

- **Half-year:** personal property gets half a year of depreciation in the years placed in service and disposed of.
- **Mid-quarter:** required for all personal property placed in service that year if more than 40% of it, by cost, was placed in service in the last quarter.
- **Mid-month:** real property.

Example, 5-year property costing \$10,000, using IRS table rates: year 1, 20% = \$2,000. Year 2, 32% = \$3,200. Year 3, 19.2% = \$1,920.

BONUS DEPRECIATION

The One Big Beautiful Bill Act (OBBBA, enacted July 4, 2025) made **100% bonus depreciation permanent** for qualified property acquired after January 19, 2025. Qualified property is generally new or used property with a recovery period of 20 years or less. Taxpayers may elect out by class.

SECTION 179 EXPENSING

Taxpayers may elect to expense qualifying property instead of depreciating it.

- **For 2026:** a limit of **\$2,560,000**, reduced dollar for dollar once qualifying purchases exceed **\$4,090,000** (Rev. Proc. 2025-32).
- The deduction can't exceed taxable income from active trades or businesses. The excess carries forward.
- Qualifying property includes tangible personal property, off-the-shelf software and certain improvements to nonresidential real property. Business use must exceed 50%.

Example: a business buys \$1,000,000 of equipment and has \$800,000 of business income. It can expense \$800,000 and carry forward \$200,000.

LISTED PROPERTY

Cars and other property that may be used personally. If business use is **50% or less**, Section 179 and accelerated depreciation aren't allowed, so straight-line under the alternative system applies. Passenger vehicles are also subject to annual "luxury auto" depreciation caps.

AMORTIZATION

- **Section 197 intangibles** acquired with a business, such as goodwill, going concern value, customer lists, covenants not to compete, licenses and franchises, are amortized straight-line over **15 years**.
- **Start-up and organizational costs:** deduct up to **\$5,000** of each in the first year, reduced dollar for dollar when the total exceeds **\$50,000**. Amortize the rest over **180 months**.

DEPLETION

For natural resources, the deduction is the greater of **cost depletion** (adjusted basis ÷ estimated recoverable units × units sold) or **percentage depletion** (a statutory rate times gross income from the property, subject to limits). Percentage depletion for oil and gas is limited to independent producers and royalty owners.

Gains and Losses

Amount realized = cash + fair value of property received + liabilities the buyer assumes or the seller is relieved of – selling costs.

Realized gain or loss = amount realized – adjusted basis.

Example: property with an \$80,000 basis is sold for \$100,000 in cash, and the buyer assumes a \$30,000 mortgage. The amount realized is \$130,000, so the gain is **\$50,000**.

Realized gains and losses are recognized unless a rule defers or disallows them: like-kind exchanges, involuntary conversions, the home sale exclusion, wash sales and losses on sales to related parties.

Section 1231, 1245 and 1250

Section 1231 property: depreciable property and land used in a trade or business and held more than one year.

- Net 1231 **gains** are treated as **long-term capital gain**.
- Net 1231 **losses** are **ordinary losses**.
- **Lookback rule:** net 1231 gain is ordinary to the extent of net 1231 losses deducted in the previous five years.

Section 1245 recapture (personal property): gain is ordinary income to the extent of all depreciation taken.

Example: equipment cost \$100,000 and has \$60,000 of depreciation, for a \$40,000 basis.

- Sold for \$90,000: the \$50,000 gain is all ordinary income.
- Sold for \$110,000: \$60,000 is ordinary and \$10,000 is Section 1231 gain.

Section 1250 (real property): only depreciation in excess of straight-line is ordinary, which is generally none for real property placed in service after 1986.

- For individuals, the gain attributable to straight-line depreciation is **unrecaptured Section 1250 gain**, taxed at a maximum 25% rate.
- **Corporations** recapture 20% of the straight-line depreciation as ordinary income under Section 291.

Like-Kind Exchanges (Section 1031)

- **Real property for real property**, both held for business or investment use. Since 2018, personal property doesn't qualify.
- Not eligible: inventory or property held for sale, securities, partnership interests and a personal residence.
- **Boot** is anything else received: cash, other property and **relief from liabilities**. Liabilities assumed by the taxpayer, and cash paid, offset liability relief.
- **Recognized gain** = the lesser of realized gain or boot received. **Losses are never recognized** in a like-kind exchange.
- **Basis of the new property** = adjusted basis of the property given + gain recognized + boot paid – boot received. Equivalently, it's the fair value of the new property minus the deferred gain.

Example 1, no boot: land with a \$100,000 basis and \$150,000 value is exchanged for a building worth \$150,000. The realized gain is \$50,000, none is recognized and the building's basis is \$100,000.

Example 2, cash boot: land with a \$100,000 basis and \$150,000 value is exchanged for land worth \$130,000 plus \$20,000 cash. The realized gain is \$50,000 and the recognized gain is \$20,000. The new land's basis is \$100,000.

+ \$20,000 – \$20,000 = **\$100,000**, which equals \$130,000 minus the \$30,000 deferred gain.

Example 3, mortgage relief: land with a \$100,000 basis, worth \$200,000 and subject to a \$60,000 mortgage, is exchanged for land worth \$140,000, with the other party taking over the mortgage.

- Amount realized: \$140,000 + \$60,000 of liability relief = \$200,000
- Realized gain: \$200,000 – \$100,000 = \$100,000
- Boot received: the \$60,000 of liability relief, so the recognized gain is **\$60,000**
- New basis: \$100,000 + \$60,000 – \$60,000 = **\$100,000**, which equals \$140,000 minus the \$40,000 deferred gain